THE GENERAL STATUTES OF NORTH CAROLINA

-

ANNOTATED

-

1994 CUMULATIVE SUPPLEMENT

VOLUME 6

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THE GENERAL STATUTES OF NORTH CAROLINA

ANNOTATED

1994 CUMULATIVE SUPPLEMENT

Volume 6

Chapters 21 through 27

Prepared under the Supervision of

The Department of Justice
of the State of North Carolina

BY

The Editorial Staff of the Publishers

Under the Direction of

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Annotated through 443 S.E.2d 468. For complete scope of annotations, see scope of volume page.

Place Behind Supplement Tab in Binder Volume. This Supersedes Previous Supplement, Which May Be Retained for Reference Purposes.

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Preface

This Cumulative Supplement to Volume 6 contains the general laws of a permanent nature enacted by the General Assembly through the 1993 (Reg. Sess., 1994) Session, which are within the scope of such volume, and brings to date the annotations included therein.

Amendments are inserted under the same section numbers appearing in the General Statutes, and new laws appear under the proper chapter headings.

Chapter analyses show all affected sections, except sections for which catchlines are carried for the purposes of notes only. An index to all statutes codified herein will appear in the Replacement Index Volumes.

A majority of the Session Laws are made effective upon ratification, but a few provide for stated effective dates. If the Session Law makes no provision for an effective date, the law becomes effective under G.S. 120-20 "from and after 30 days after the adjournment of the session" in which passed.

Beginning with the opinions issued by the North Carolina Attorney General on July 1, 1969, any opinion which construes a specific statute is cited as an annotation to that statute. For a copy of an opinion or of its headnotes write the Attorney General, P. O. Box 629, Raleigh, N.C. 27602.

The members of the North Carolina Bar are requested to communicate any defects they may find in the General Statutes or in this Cumulative Supplement and any suggestions they may have for improving the General Statutes, to the Department of Justice of the State of North Carolina, or to The Michie Company, Law Publishers, Charlottesville, Virginia.

User's Guide

In order to assist both the legal profession and the layperson in obtaining the maximum benefit from the North Carolina General Statutes, a User's Guide has been included in Volume 1. This guide contains comments and information on the many features found within the General Statutes intended to increase the usefulness of this set of laws to the user. See Volume 1 for the complete User's Guide.

Scope of Volume

Statutes:

Permanent portions of the General Laws enacted by the General Assembly through the 1993 (Reg. Sess., 1994) Session affecting Chapters 21 through 27 of the General Statutes.

Annotations:

Sources of the annotations to the General Statutes appearing in this volume are:

North Carolina Reports through Volume 336, p. 77.
North Carolina Court of Appeals Reports through Volume 114, p. 505.
South Eastern Reporter 2nd Series through Volume 443, p. 468.
Federal Reporter 3rd Series through Volume 21, p. 1127.
Federal Supplement through Volume 848, p. 212.
Federal Rules Decisions through Volume 154, p. 535.
Bankruptcy Reports through Volume 166, p. 498.
Supreme Court Reporter through Volume 114, p. 1877.
North Carolina Law Review through Volume 72, p. 1128.
Wake Forest Law Review through Volume 29, p. 646.
Campbell Law Review through Volume 16, p. 145.
Duke Law Journal through Volume 43, p. 1348.
North Carolina Central Law Journal through Volume 20, p. 229.
Opinions of the Attorney General.

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Chapter 22.
Contracts Requiring Writing.

Sec.
22-5. Commercial loan commitments.

§ 22-1. Contracts charging representative personally; promise to answer for debt of another.

CASE NOTES

I. In General.
III. Promise to Answer for Debt of Another.
  B. Illustrative Cases.

I. IN GENERAL.

Contracts for Services. — There is no requirement in this State that contracts for services not to be performed within a year be in writing and signed by the party to be charged therewith. Messer v. Laurel Hill Assocs., 93 N.C. App. 439, 378 S.E.2d 220 (1989).

Cited in Forbes Homes, Inc. v. Trimpi, 318 N.C. 473, 349 S.E.2d 852 (1986).

III. PROMISE TO ANSWER FOR DEBT OF ANOTHER.

B. Illustrative Cases.

A promise to pay a decedent's debts must be in writing when such debts are generally charged to the decedent's estate. Parrish Funeral Home v. Pittman, 104 N.C. App. 268, 409 S.E.2d 327 (1991).

Promise to Pay Funeral Expenses. — Defendant's alleged promise to pay funeral expenses for his deceased father if the estate did not was a promise to pay the debt of another, which is void by law unless in writing. Parrish Funeral Home v. Pittman, 104 N.C. App. 268, 409 S.E.2d 327 (1991), holding, however, that as defendants did not specifically plead the statute of frauds, it was not available as a defense.

Testimony of Promise to Pay Former Wife's Debt to Plaintiff Allowed. — Trial court did not err in allowing testimony of oral communications concerning defendant's promise to pay former wife's debt to plaintiff; defendant's promise constituted an original promise, and therefore was not subject to the writing requirement where defendant promised plaintiff that he would make all of the monthly payments on the mortgage note; furthermore, he made the agreement directly with plaintiff, rather than solely with former wife to pay off her debt to her mother, and defendant's promise to plaintiff was supported by independent consideration; namely, plaintiff pledged her own residence as collateral and obtained for defendant a $25,000 loan. Effler v. Pyles, 94 N.C. App. 349, 380 S.E.2d 149 (1989).

§ 22-2. Contract for sale of land; leases.

Legal Periodicals. — For note on waiver of closing date in land sales contracts in North Carolina, in light of Fletcher v. Jones, 314 N.C. 389, 333 S.E.2d 731 (1985), see 8 Campbell L. Rev. 546 (1986).

For article, "Private Land Use Controls: Enforcement Problems with Real Covenants and Equitable Servitudes in North Carolina," see 22 Wake Forest L. Rev. 749 (1987).

CASE NOTES

I. In General.
II. What Constitutes an Interest in or Concerning Land.
III. Sufficiency of Compliance with Section.
    A. In General.

I. IN GENERAL.

Parol assurances made by a developer to prospective buyers regarding the general scheme or plans of development that the developer intends to pursue are admissible to establish the existence of such a scheme. Such parol evidence may be in the form of a field map, sales brochures, maps, advertising or oral statements on which purchasers relied. River Birch Assocs. v. City of Raleigh, 326 N.C. 100, 388 S.E.2d 538 (1990).

Use of parole evidence to determine area referred to in declaration of covenants. — In determining whether subdivision common area included a certain three-acre parcel, the trial court improperly excluded evidence of statements made by agents to buyers, and should have admitted preliminary plat and landscaping plan as maps tending to identify the common area referred to in the declaration of covenants. River Birch Assocs. v. City of Raleigh, 326 N.C. 100, 388 S.E.2d 538 (1990).

Applied in Britt v. Britt, 320 N.C. 573, 359 S.E.2d 467 (1987); Schafer v. Barrier Island Station, Inc., 946 F.2d 1075 (4th Cir. 1991).

Cited in Sprouse v. North River Ins. Co., 81 N.C. App. 311, 344 S.E.2d 555 (1986); Brooks v. Hackney, 329 N.C. 166, 404 S.E.2d 854 (1991).

II. WHAT CONSTITUTES AN INTEREST IN OR CONCERNING LAND.

Parol Agreement as to Division of Profits, etc. —

The statute of frauds does not apply where a party seeks to prove an oral agreement with respect to the disposition of proceeds from a sale of land, rather than to force or prevent conveyance of the land itself. Rongotes v. Pridemore, 88 N.C. App. 363, 363 S.E.2d 221 (1988).

III. SUFFICIENCY OF COMPLIANCE WITH SECTION.

A. In General.

It is Not Necessary, etc. —

The statute of frauds does not require all the provisions of the contract to be set out in a single instrument. The memorandum required by the statute is sufficient if the contract provisions can be determined from separate but related writings. Rose v. Lang, 85 N.C. App. 690, 355 S.E.2d 795 (1987).

Writing Must Describe Subject Matter. —

A deed or contract to sell land must contain, among other things, sufficient description of land to be sold or conveyed, to satisfy statute of frauds. To be sufficient, description must be certain in itself or capable of being reduced to certainty by reference to something extrinsic to which contract refers. Brooks v. Hackney, 100 N.C. App. 562, 397 S.E.2d 361 (1990), rev'd on other grounds, 329 N.C. 166, 404 S.E.2d 854 (1991).

Property descriptions that purport to carve small tracts of land out of larger tracts must specifically identify part to be conveyed in order to comply with statute of frauds. Brooks v. Hackney, 100 N.C. App. 562, 397 S.E.2d 361 (1990), rev'd on other grounds, 329 N.C. 166, 404 S.E.2d 854 (1991).

When Patent Ambiguity Exists. —

Patent ambiguity is such an uncertainty appearing on face of instrument that a court, reading language in light of all facts and circumstances referred to in instrument, is unable to derive therefrom intention of the parties as to what land was to be conveyed. Brooks v. Hackney, 100 N.C. App. 562, 397 S.E.2d 361 (1990), rev'd on other grounds, 329 N.C. 166, 404 S.E.2d 854 (1991).

Whether Ambiguity Is Patent or Latent Is Question of Law. — Where ambiguity exists in a property description contained in writing, it is question of law to be decided by court as to whether ambiguity is patent or latent. Brooks v. Hackney, 100 N.C. App. 562, 397 S.E.2d 361 (1990), rev'd on other grounds, 329 N.C. 166, 404 S.E.2d 854 (1991).

Patent Ambiguity Precludes Use of Parol Evidence. —

Parol evidence is not admitted to explain patent ambiguities. Brooks v. Hackney, 100 N.C. App. 562, 397 S.E.2d 361 (1990), rev'd on other grounds, 329 N.C. 166, 404 S.E.2d 854 (1991).

Vague and Indefinite Description of Land Void. — If description of land is so vague and indefinite that effect cannot be given instrument without writing new, material language into it, then it is void and ineffectual. Brooks v. Hackney, 100 N.C. App. 562, 397 S.E.2d 361 (1990), rev'd on other grounds, 329 N.C. 166, 404 S.E.2d 854 (1991).

Writing did not sufficiently describe particular twenty-five acre portion of tract because northern boundary, described as "with the Whitehead line. Thence straight to road that goes by Plainfield Church ..." could have been drawn in infinite number of ways. Accordingly, as a matter of law, the contract was void under statute of frauds and not enforceable. Brooks v. Hackney, 100 N.C. App. 562, 397 S.E.2d 361 (1990), rev'd on other grounds, 329 N.C. 166, 404 S.E.2d 854 (1991).

§ 22-3. Contracts with Cherokee Indians.

Legal Periodicals. — For an article on criminal jurisdiction on the North Carolina Cherokee Indian reservation, see 24 Wake Forest L. Rev. 335 (1989).

§ 22-5. Commercial loan commitments.

No commercial loan commitment by a bank, savings and loan association, or credit union for a loan in excess of fifty thousand dollars ($50,000) shall be binding unless the commitment is in writing and signed by the party to be bound. As used in this section, the term "commercial loan commitment" means an offer, agreement, commitment, or contract to extend credit primarily for business or commercial purposes and does not include charge or credit card accounts, personal lines of credit, overdrafts, or any other consumer account. Offers, agreements, commitments, or contracts to extend credit primarily for aquaculture, agricultural, or farming purposes are specifically exempted from the provisions of this section. (1989, c. 678.)

Editor's Note. — Session Laws 1989, c. 678, s. 2 made this section effective on October 1, 1989, and applicable to commercial loan commitments entered into on or after that date.

Chapter 22B.

Editor's Note. — The legislation and annotations affecting Chapter 22B have been included in a recently published replacement chapter.

Chapter 22C.

Payments to Subcontractors.

Sec.
22C-2. Performance by subcontractor.

§ 22C-2. Performance by subcontractor.

Performance by a subcontractor in accordance with the provisions of its contract shall entitle it to payment from the party with whom it contracts. Payment by the owner to a contractor is not a condition precedent for payment to a subcontractor and payment by a contractor to a subcontractor is not a condition precedent for payment to any other subcontractor, and an agreement to the contrary is unenforceable. (1987 (Reg. Sess., 1988), c. 946, s. 1; 1991, c. 620, s. 1.)

Effect of Amendments. — The 1991 amendment, effective July 9, 1991, and applicable to those contracts entered into on or after July 9, 1991, added the second sentence.

CASE NOTES

Timing of Payment to Subcontractor. — Section 22C-3 addresses only the issue of what is to be done when the general contractor has already been paid, but says nothing about what happens when the owner does not pay; in effect, it sets an outer boundary for payment to the subcontractor of seven days after the general contractor has been paid, but it does not eliminate the possibility that the sub may be entitled to payment earlier than that. If the legislature had intended to overturn the rule established by Howard-Green Elec. Co. v. Chaney & James Constr. Co., 12 N.C. App. 63, 182 S.E.2d 601 (1971), it would have done so in unmistakable language. Statesville Roofing & Heating Co. v. Duncan, 702 F. Supp. 118 (W.D.N.C. 1988).

§ 22C-3. Time of payment to subcontractors after contractor or other subcontractor has been paid.

CASE NOTES

This section addresses only the issue of what is to be done when the general contractor has already been paid, but says nothing about what happens when the owner does not pay; in effect, it sets an outer boundary for payment to the subcontractor of seven days after the general contractor has been paid, but it does not eliminate the possibility that the sub may be entitled to payment earlier than that. If the legislature had intended to overturn the rule established by Howard-Green Elec. Co. v. Chaney & James Constr. Co., 12 N.C. App. 63, 182 S.E.2d 601 (1971), it would have so in unmistakable language. Statesville Roofing & Heating Co. v. Duncan, 702 F. Supp. 118 (W.D.N.C. 1988).

Chapter 23.

Debtor and Creditor.

Article 1.

Assignments for Benefit of Creditors.

Sec.
23-9. (Effective October 1, 1994 — See editor's note) Creditors to file verified claims with clerk; false swearing misdemeanor.
23-12. (Effective October 1, 1994 — See editor's note) Trustee violating duties guilty of misdemeanor.

Article 5.

General Provisions under Articles 2, 3, and 4.

Sec.
23-43. (Effective October 1, 1994 — See editor's note) False swearing; penalty.

Article 6.

Practice in Insolvency and Certain Other Proceedings.

23-47. (Effective October 1, 1994 — See editor's note) Violation of preceding section a misdemeanor.

ARTICLE 1.

Assignments for Benefit of Creditors.

§ 23-9. (Effective October 1, 1994 — See editor's note) Creditors to file verified claims with clerk; false swearing misdemeanor.

All creditors of the maker of such deed of trust shall, before receiving payment of any amount from the said trustee, file with the clerk of the superior court a statement under oath that the amount claimed by him is justly due, after allowing all credits and offsets, to the best of his knowledge and belief. Any creditor who shall knowingly swear falsely in such statement shall be guilty of a Class 1 misdemeanor. (1893, c. 453, ss. 6, 7; Rev., ss. 972, 3617; C.S., s. 1617; 1993, c. 539, s. 397; 1994, Ex. Sess., c. 14, s. 34; c. 24, s. 14(c).)

Editor's Note. — Session Laws 1993, c. 539, which amended this section, in s. 1359, as amended by Session Laws 1994, Extra Session, c. 24, s. 14(c), provides: "This act becomes effective October 1, 1994, and applies to offenses occurring on or after that date. Prosecutions for offenses committed before the effective date of this act are not abated or affected by this act, and the statutes that would be applicable but for this act remain applicable to those prosecutions."

Session Laws 1994, Extra Session, c. 14, s. 73 provides: "Prosecutions for offenses committed before the effective date of this act [October 1, 1994] are not abated or affected by this act, and the statutes that would be applicable but for this act remain applicable to those prosecutions."

Effect of Amendments. — The 1993 amendment, effective October 1, 1994, and applicable to offenses occurring on or after that date, inserted "Class 1 misdemeanor" preceding "misdemeanor."

The 1994 Extra Session amendment, effective on the same date that Chapter 539 of the 1993 Session Laws becomes effective (October 1, 1994), and applicable to offenses occurring on or after that date, deleted the first occurrence of "misdemeanor" following "Class 1."

§ 23-12. (Effective October 1, 1994 — See editor's note) Trustee violating duties guilty of misdemeanor.

If any trustee in a deed of trust for the benefit of creditors shall fail to file his inventory as required by law, or shall knowingly make any false statement in such inventory, or shall knowingly fail to include any property therein, or shall sell any part of the property described in the deed of trust within ten days unless such property so sold be perishable, or shall fail to file either of the quarterly accounts or the final accounts as required by law, or shall knowingly make any false statement in such quarterly or final account, or shall knowingly fail to include any property, money or disbursement in such quarterly or final account, he shall, in either case, be guilty of a Class 1 misdemeanor. (1893, c. 453, s. 8; Rev., s. 3689; C.S., s. 1620; 1993, c. 539, s. 398; 1994, Ex. Sess., c. 24, s. 14(c).)

Editor's Note. — Session Laws 1993, c. 539, which amended this section, in s. 1359, as amended by Session Laws 1994, Extra Session, c. 24, s. 14(c), provides: "This act becomes effective October 1, 1994, and applies to offenses occurring on or after that date. Prosecutions for offenses committed before the effective date of this act are not abated or affected by this act, and the statutes that would be applicable but for this act remain applicable to those prosecutions."

Effect of Amendments. — The 1993 amendment, effective October 1, 1994, and applicable to offenses occurring on or after that date, inserted "Class 1" preceding "misdemeanor."

ARTICLE 5.

General Provisions under Articles 2, 3, and 4.

§ 23-43. (Effective October 1, 1994 — See editor's note) False swearing; penalty.

If any insolvent or imprisoned debtor takes any oath prescribed in this chapter falsely and corruptly, that person is guilty of a Class I felony, and he shall never after have any of the benefits of this chapter, but may be sued and imprisoned as though he had never been discharged. (1793, c. 100, s. 10, P.R.; R.C., c. 59, s. 25; 1868-9, c. 162, s. 23; Code, s. 2964; Rev., ss. 1940, 3614; C.S., s. 1651; 1993, c. 539, s. 1263; 1994, Ex. Sess., c. 24, s. 14(c).)

Editor's Note. — Session Laws 1993, c. 539, which amended this section, in s. 1359, as amended by Session Laws 1994, Extra Session, c. 24, s. 14(c), provides: "This act becomes effective October 1, 1994, and applies to offenses occurring on or after that date. Prosecutions for offenses committed before the effective date of this act are not abated or affected by this act, and the statutes that would be applicable but for this act remain applicable to those prosecutions."

Effect of Amendments. — The 1993 amendment, effective October 1, 1994, and applicable to offenses occurring on or after that date, substituted "that person is guilty of a Class 1 felony" for "and upon indictment for perjury is convicted thereof, he shall suffer all the pains of perjury."

ARTICLE 6.

Practice in Insolvency and Certain Other Proceedings.

§ 23-47. (Effective October 1, 1994 — See editor's note) Violation of preceding section a misdemeanor.

Any individual, corporation, or firm or other association of persons violating any provision of G.S. 23-46 shall be guilty of a Class 1 misdemeanor. (1931, c. 208, s. 3; 1993, c. 539, s. 399; 1994, Ex. Sess., c. 24, s. 14(c).)

Editor's Note. — Session Laws 1993, c. 539, which amended this section, in s. 1359, as amended by Session Laws 1994, Extra Session, c. 24, s. 14(c), provides: "This act becomes effective October 1, 1994, and applies to offenses occurring on or after that date. Prosecutions for offenses committed before the effective date of this act are not abated or affected by this act, and the statutes that would be applicable but for this act remain applicable to those prosecutions."

Effect of Amendments. — The 1993 amendment, effective October 1, 1994, and applicable to offenses occurring on or after that date, inserted "Class 1" preceding "misdemeanor."

Chapter 24.

Interest.

Article 1.

General Provisions.

Sec.
24-8. Loans not in excess of $300,000; what interest, fees and charges permitted.
24-10.1. Late fees.

Article 2.

Loans Secured by Secondary or Junior Mortgages.

Sec.
24-14. Limitations on charges and interest.
24-17. (Effective October 1, 1994 — See editor's note) Misdemeanors.

ARTICLE 1.

General Provisions.

§ 24-1. Legal rate is eight percent.

CASE NOTES

Unless Defendant Agreed to Rate Set Pay Court. — Where defendant agreed to let the trial court set the rate of interest, he could not on appeal argue that the trial court lacked authority to set the interest rate above the legal rate. Coston v. Coston, 109 N.C. App. 306, 426 S.E.2d 460 (1993).

For the last three words of this section to be of any significance, it must necessarily be inferred that interest may be imposed on judgments at a rate less than 8% if requested by the party entitled to the interest. Where a plaintiff's attorney prepared a 1980 judgment asking for 6%, court would presume that is what he intended. Speros Constr. Co. v. Musselwhite, 103 N.C. App. 510, 405 S.E.2d 785 (1991).

Fraudulent Procurement of Money. — No implied contract resulted from a defendant's act of fraudulently obtaining the money from a plaintiff or from a court's order that the defendant pay restitution to the plaintiff, because there was no meeting of the minds between the parties. The law in effect at the time of an agreement determines the rate of interest on an obligation only where an agreement has actually been reached. Otherwise, the law in effect at the time of judgment determines the rate of interest. Speros Constr. Co. v. Musselwhite, 103 N.C. App. 510, 405 S.E.2d 785 (1991).

Where a plaintiff brought an action to prevent the 10-year statute of limitations from barring his recovery on a prior judgment, the action was in the nature of an independent action on the judgment, the only procedure in this state by which a judgment can be renewed. As it was a separate and distinct action, the plaintiff could request, in his complaint, interest at the legal rate of 8%, and the trial court could award interest at that rate from the date the present action was instituted until the judgment is satisfied. Speros Constr. Co. v. Musselwhite, 103 N.C. App. 510, 405 S.E.2d 785 (1991).

Applied in Leggett v. Rose, 776 F. Supp. 229 (E.D.N.C. 1991).

Cited in Borg-Warner Acceptance Corp. v. Johnston, 107 N.C. App. 174, 419 S.E.2d 195 (1992), cert. denied, 333 N.C. 254, 424 S.E.2d 918 (1993).

§ 24-1.1. Contract rates and fees.

CASE NOTES

Section 25-9-203 does not make an Article 9 transaction subject to this section. Borg-Warner Acceptance Corp. v. Johnston, 107 N.C. App. 174, 419 S.E.2d 195 (1992), cert. denied, 333 N.C. 254, 424 S.E.2d 918 (1993).

Fraudulent Procurement of Money. — No implied contract resulted from a defendant's act of fraudulently obtaining the money from a plaintiff or from a court's order that the defendant pay restitution to the plaintiff, because there was no meeting of the minds between the parties. The law in effect at the time of an agreement determines the rate of interest on an obligation only where an agreement has actually been reached. Otherwise, the law in effect at the time of judgment determines the rate of interest. Speros Constr. Co. v. Musselwhite, 103 N.C. App. 510, 405 S.E.2d 785 (1991).

Stated in West Raleigh Group v. Massachusetts Mut. Life Ins. Co., 809 F. Supp. 384 (E.D.N.C. 1992).

Cited in Hatcher v. Rose, 329 N.C. 626, 407 S.E.2d 172 (1991).

§ 24-1.1A. Contract rates on home loans secured by first mortgages or first deeds of trust.

CASE NOTES

Prepayment Allowed Prior to Enactment of § 24-2.4. — Considering the acts of the General Assembly, specifically § 24-10 and this section, the law of North Carolina prior to the enactment of § 24-2.4 was that the mortgagor had the right of prepayment when the note was silent. Hatcher v. Rose, 329 N.C. 626, 407 S.E.2d 172 (1991).

Stated in West Raleigh Group v. Massachusetts Mut. Life Ins. Co., 809 F. Supp. 384 (E.D.N.C. 1992).

Cited in Swindell v. Federal Nat'l Mtg. Assoc., 330 N.C. 153, 409 S.E.2d 892 (1991).

§ 24-2. Penalty for usury; corporate bonds may be sold below par.

Legal Periodicals. —

For survey on usury law, see 70 N.C.L. Rev. 1983 (1992).

CASE NOTES

I. General Consideration.

I. GENERAL CONSIDERATION.

Late Payment Fees Are "Interest". — The General Assembly, which specified a maximum legal rate for late payment fees in § 24-10.1, considered such fees "interest" and intended to induce observance of that law through the penalty provisions of this section. Swindell v. Federal Nat'l Mtg. Assoc., 330 N.C. 153, 409 S.E.2d 892 (1991).

Penalty fees for late payments are "interest" and are compensation for the detention of money owed another, and all such compensation must be forfeited when its rate is usurious, as defined by the laws of this state. Swindell v. Federal Nat'l Mtg. Assoc., 330 N.C. 153, 409 S.E.2d 892 (1991).

This Section Applicable to Enforce Violations of § 24-10.1. — The statutory penalty for usury requires a defendant which has charged late payments in excess of the legal maximum rate permitted by former § 24-10(e) (see now § 24-10.1) to forfeit all late payment charges to which it might otherwise have been entitled under the terms of the loan, but defendant is not required to forfeit the interest due on the loan itself. Swindell v. Federal Nat'l Mtg. Assoc., 330 N.C. 153, 409 S.E.2d 892 (1991).

Cited in Borg-Warner Acceptance Corp. v. Johnston, 107 N.C. App. 174, 419 S.E.2d 195 (1992).

§ 24-2.1. Transactions governed by Chapter.

CASE NOTES

Chapter Places Burden of Expertise on Lender. — The usury statutes relieve the borrower of the necessity for expertise and vigilance regarding the legality of rates he must pay. That onus is placed instead on the lender, whose business it is to lend money for profit and who is thus in a better position than the borrower to know the law. Swindell v. Federal Nat'l Mtg. Assoc., 330 N.C. 153, 409 S.E.2d 892 (1991).

"Usury Savings Clause". — A lender cannot charge usurious rates with impunity via a "usury savings clause," by making that rate conditional upon its legality and relying upon the illegal rate's automatic rescission when discovered and challenged by the borrower. Swindell v. Federal Nat'l Mtg. Assoc., 330 N.C. 153, 409 S.E.2d 892 (1991).

§ 24-2.4. Prepayment of a loan if there are no prepayment terms or if the prepayment terms are not in accordance with law.

CASE NOTES

Prepayment Allowed Prior to Enactment of this Section. — Considering the acts of the General Assembly, specifically §§ 24-10 and 24-1.1A, the law of North Carolina prior to the enactment of this section was that the mortgagor had the right of prepayment when the note was silent. Hatcher v. Rose, 329 N.C. 626, 407 S.E.2d 172 (1991).

Prepayment was allowed on a promissory note executed before the enactment of this section, and for the purchase of real estate even though the note did not by specific language either prohibit or permit prepayment. Hatcher v. Rose, 329 N.C. 626, 407 S.E.2d 172 (1991).

§ 24-5. Contracts, except penal bonds, and judgments to bear interest.

CASE NOTES

I. In General.
III. Other Actions.
IV. Prejudgment Interest.

I. IN GENERAL.

This section is not a part of the Financial Responsibility Act; therefore, its provisions need not be written into every automobile liability insurance policy. Sproles v. Greene, 329 N.C. 603, 407 S.E.2d 497 (1991).

III. OTHER ACTIONS.

It Is Discretionary with Jury, etc. —

Under law the jury has discretion to

award prejudgment interest in tort cases involving property losses. Leggett v. Rose, 776 F. Supp. 229 (E.D.N.C. 1991).

Recovery Under Uninsured Motorist Policy. — Where insurance coverage provided for "damages which the plaintiff is legally entitled to recover" from the owner or operator of the uninsured motor vehicle; the plaintiff's claim was based in tort, despite the fact that recovery was derivative and conditional; and the defendant assumed up to its policy limits the liability of the uninsured motorist for damages which the plaintiff was legally entitled to recover from the uninsured motorist, the action fell under subsection (b) of this section, (i.e. was an "other action"), and the plaintiff was entitled to recover interest from the defendant, up to the policy limits. Baxley v. Nationwide Mut. Ins. Co., 104 N.C. App. 419, 410 S.E.2d 12 (1991), aff'd, 334 N.C. 1, 430 S.E.2d 895 (1993).

Where a plaintiff brought an action to prevent the 10-year statute of limitations from barring his recovery on a prior judgment, the action was in the nature of an independent action on the judgment, the only procedure in this state by which a judgment can be renewed. As it was a separate and distinct action, the plaintiff could request, in his complaint, interest at the legal rate of eight percent, and the trial court could award interest at that rate from the date the present action was instituted until the judgment is satisfied. Speros Constr. Co. v. Musselwhite, 103 N.C. App. 510, 405 S.E.2d 785 (1991).

IV. PREJUDGMENT INTEREST.

Prejudgment Interest Held Not a Cost Within Meaning of Policy. — Where insurance policy provided that, in addition to the policy limits, insurance company would pay all defense costs they incurred, prejudgment interest was not a defense cost within the meaning of the policy. Sproles v. Greene, 329 N.C. 603, 407 S.E.2d 497 (1991).

Prejudgment Interest on Limits of Policy and Excess. — Where trial court granted prejudgment interest on only $5,000 that remained due on $30,000 judgment after subtracting $25,000 policy limits paid by the liability carrier after the filing date of the complaint but before the judgment, the trial court erred in failing to award prejudgment interest on the $25,000 paid by the liability carrier from the filing date until it was paid by the liability carrier. Regarding the remaining $5,000, prejudgment interest should have been taxed from the date of filing to the time of judgment as a cost, less any interest already paid. Beaver v. Hampton, 106 N.C. App. 172, 416 S.E.2d 8 (1992), rev'd in part and aff'd in part, 333 N.C. 455, 427 S.E.2d 317 (1993).

Action Against Underinsured Motorist Carrier. — Underinsured motorist carrier was obligated to pay prejudgment interest, up to its policy limits, on the compensatory damages award of the jury in the underlying tort action by its insured against the tort-feasor. Baxley v. Nationwide Mut. Ins. Co., 334 N.C. 1, 430 S.E.2d 895 (1993).

§ 24-8. Loans not in excess of $300,000; what interest, fees and charges permitted.

No lender shall charge or receive from any borrower or require in connection with a loan any borrower, directly or indirectly, to pay, deliver, transfer or convey or otherwise confer upon or for the benefit of the lender or any other person, firm or corporation any sum of money, thing of value or other consideration other than that which is pledged as security or collateral to secure the repayment of the full principal of the loan, together with fees and interest provided for in this Chapter or Chapter 53 of the North Carolina General Statutes, where the principal amount of a loan is not in excess of three hundred thousand dollars ($300,000.00); provided, this section shall not prevent a borrower from selling, transferring, or conveying property other than security or collateral to any person, firm or corporation for a fair consideration so long as such transaction is not made a condition or requirement for any loan; provided that this shall not prevent the lender from collecting from the borrower for remittance to others, money in payment of taxes, assessments, cost of upkeep, recording fees, surveys, attorneys' fees, fire, title, life, accident and health, unemployment, and mortgage insurance premiums and other such fees and costs, nor from receiving the proceeds from any insurance policies where a loss occurs under the terms of such policies. This section shall not be applicable to any corporation licensed as a "Small Business Investment Company" under the provisions of the United States Code Annotated, Title 15, section 661, et seq. nor shall it be applicable to the sale or purchase of convertible debentures, nor to the sale or purchase of any debt security with accompanying warrants, nor to the sale or purchase of other securities through an organized securities exchange. (1961, c. 1142; 1969, c. 127; c. 1303, s. 5; 1993, c. 226, s. 12.)

Effect of Amendments. — The 1993 amendment, effective January 1, 1994, in the first sentence substituted "this Chapter or Chapter 53" for "chapter 24 or chapter 53" and, in the second proviso, inserted "accident and health, unemployment," following "life."

CASE NOTES

Stated in West Raleigh Group v. Massachusetts Mut. Life Ins. Co., 809 F. Supp. 384 (E.D.N.C. 1992).

§ 24-10. Maximum fees on loans secured by real property.

CASE NOTES

Purpose. — The wisdom of the statute, and others like it, is manifest. First the statute preserves freedom of contract, a principle long recognized and jealously guarded in North Carolina. Secondly, the statute recognizes the borrowers and lenders are best able in a free market place to determine for themselves what prepayment terms are acceptable, "reasonable," "proportionate," and "fair." The statute recognizes that prepayment provisions are part an parcel of the overall loan terms and, as such, are better left to the agreement of the parties. West Raleigh Group v. Massachusetts Mut. Life Ins. Co., 809 F. Supp. 384 (E.D.N.C. 1992).

Section Held Applicable. — Note executed in connection with a $2.8 million real estate loan was clearly in excess of $100,000 and was not alleged to be a "construction loan"; there could be no serious argument that the partner did not agree upon the contested prepayment provisions, since those provisions were expressly a part of the Note. Accordingly, subsection (b) of this section was applicable to the note and that the enforceability of the prepayment terms of the note was governed by it. West Raleigh Group v. Massachusetts Mut. Life Ins. Co., 809 F. Supp. 384 (E.D.N.C. 1992).

Prepayment Prior to Enactment of § 24-2.4. — Considering the acts of the General Assembly, specifically this section and § 24-1.1A, the law of North Carolina prior to the enactment of § 24-2.4 was that the mortgagor had the right of prepayment when the note was silent. Hatcher v. Rose, 329 N.C. 626, 407 S.E.2d 172 (1991).

§ 24-10.1. Late fees.

(a) Subject to the limitations contained in subsection (b) of this section, any lender may charge a party to a loan or extension of credit governed by the provisions of G.S. 24-1.1, 24-1.2, or 24-1.1A a late payment charge as agreed upon by the parties in the loan contract.

(b) No lender may charge a late payment charge:

(1) In excess of four percent (4%) of the amount of the payment past due; or

(2) In excess of the amount disclosed with particularity to the borrower pursuant to the provisions of the Federal Consumer Credit Protection Act if the transaction is one to which the provisions of that act apply, which in no event shall exceed four percent (4%); or

(3) For any payment unless past due for 15 days or more; provided, however, if the loan is one on which interest on each installment is paid in advance, no late payment charge may be charged until the payment is 30 days past due or more; or

(4) More than once with respect to a single late payment. If a late payment charge is deducted from a payment made on the contract and such deduction results in a subsequent default on a subsequent payment, no late payment charge may be imposed for such default. If a late payment charge has been once imposed with respect to a particular late payment, no such charge shall be imposed with respect to any future payment which would have been timely and sufficient but for the previous default; provided that when a borrower fails to make an installment payment, and the terms of the loan agreement provide that subsequent payments shall first be applied to the past due balance, and the borrower resumes making installment payments but has not paid all past due installments, then the lender may enforce the contract according to its terms, imposing a separate late payment charge for each installment that becomes due until the default is cured; or

(5) On any loan which by its terms calls for repayment of the entire balance in a single payment and not for installments of interest or principal and interest; or

(6) Unless the lender notifies the borrower within 45 days following the date the payment was due that a late payment charge has been imposed for a particular late payment which late payment must be paid unless the borrower can show that the installment was paid in full and on time. No late payment charge may be collected from any borrower if the borrower informs the lender that non-payment of an installment is in dispute and presents proof of payment within 45 days of receipt of the lender's notice of the late charge.

(c) The provisions of this subsection apply only to home loans made by lenders described in G.S. 24-1.1A(a)(2). Notwithstanding that the note or other loan document sets forth a late payment charge in excess of that permitted in this section, the loan shall not be deemed to be unlawful if:

(1) No late fee in excess of those permitted in this section has been assessed or collected by the lender; and

(2)a. If the loan is executed on or after July 14, 1993, the lender provides written notice to the borrower within 90 days of the date of execution of the loan documents that the late payment charge with respect to the loan shall be four percent (4%) or less; or

b. If the loan was executed prior to July 14, 1993, the lender provides written notice to the borrower within six months of that date that the late payment charge with respect to the loan shall be four percent (4%) or less. (1985, c. 755, s. 1; 1987, c. 447; 1993, c. 339, s. 1.)

Effect of Amendments. — The 1993 amendment, effective July 14, 1993, added subsection (c).

Legal Periodicals. — For survey on usury law, see 70 N.C.L. Rev. 1983 (1992).

CASE NOTES

Penalty fees for late payments are "interest" and are compensation for the detention of money owed another, and all such compensation must be forfeited when its rate is usurious, as defined by the laws of this state. Swindell v. Federal Nat'l Mtg. Assoc., 330 N.C. 153, 409 S.E.2d 892 (1991).

Change for Lender's Forbearance in Collecting Charge Is Interest. — Just as a charge for a creditor's forbearance in the collection of a debt is interest, so a charge for a lender's forbearance in collecting a payment due is interest. Swindell v. Federal Nat'l Mtg. Assoc., 330 N.C. 153, 409 S.E.2d 892 (1991).

Penalty Provisions of § 24-2 Applicable. — The General Assembly, which specified a maximum legal rate for late payment fees in this section, considered such fees "interest" and intended to induce observance of that law through the penalty provisions of § 24-2. Swindell v. Federal Nat'l Mtg. Assoc., 330 N.C. 153, 409 S.E.2d 892 (1991).

Violator Not Required to Forfeit Interest Due on Loan Itself. — The statutory penalty for usury requires a defendant which has charged late payments in excess of the legal maximum rate permitted by former § 24-10(e) (see now this section) to forfeit all late payment charges to which it might otherwise have been entitled under the terms of the loan, but defendant is not required to forfeit the interest due on the loan itself. Swindell v. Federal Nat'l Mtg. Assoc., 330 N.C. 153, 409 S.E.2d 892 (1991).

Cited in Beau Rivage Plantation, Inc. v. Melex USA, Inc., 112 N.C. App. 446, 436 S.E.2d 152 (1993).

§ 24-11. Certain revolving credit charges.

CASE NOTES

Cited in Sears, Roebuck & Co. v. Vandeusen, 155 Bankr. 358 (E.D.N.C. 1993).

ARTICLE 2.

Loans Secured by Secondary or Junior Mortgages.

§ 24-14. Limitations on charges and interest.

(a) No person, copartnership, association, trust, corporation or other legal entity making loans under this Article may charge, take or receive, directly or indirectly, simple interest in excess of one and one-half percent ($1\frac{1}{2}$%) per month or an annual rate equivalent to the Federal Discount Rate plus five percent (5%), whichever is the greater, computed on the actual or average daily unpaid balance of the principal amount of the loan for the time actually outstanding. However, interest may not be compounded.

(b) In addition to the interest permitted in subsection (a), the lender may include in the loan his actual expenses which are paid to third parties in connection with the loan. Such expenses shall be limited to those for: title examination, title insurance, appraisals, surveys, and recording fees or releasing fees to trustees or public officials, and only such insurance charges as permitted in subsection (c).

(c) Evidence of hazard insurance may be required by the lender of the borrower. Credit life, credit accident and health, and credit unemployment insurance, or any of them, may be offered but not required; provided (i) that the borrower has indicated a desire to purchase such insurance by signing a statement to that effect, (ii) that the borrower is advised that he may acquire this insurance from any insurance carrier, (iii) that the borrower is aware that this insurance may be rescinded within 30 days after receipt of the policy or certificate, and (iv) that the borrower directs the lender to purchase the above insurance from the proceeds of his loan.

The rates for the herein described insurance shall not exceed the standard rates approved by the Commissioner of Insurance for such insurance. Proof of all insurance issued in connection with loans subject to this Article shall be furnished to the borrower within 10 days from the date of application therefor by said borrower.

(d) No application fee or other charge shall be allowed in the event the loan is not consummated.

(e) The borrower shall further have the right to anticipate payment of his debt in whole or in part at any time, without payment of interest penalty, or any other fee or charge for such prepayment.

(f) In addition to the interest permitted by subsection (a), the lender may include in the principal balance fees or discounts not exceeding two percent (2%) of the principal amount of the loan less the amount of any existing loan by that lender to be refinanced, modified or extended. The fees and discounts are fully earned when the loan is made and are not a prepayment penalty. (1971, c. 1229, s. 2; 1973, c. 1150; 1977, c. 698, ss. 1, 2; 1979, 2nd Sess., c. 1157, ss. 5, 6; 1985, c. 154, s. 4; 1993, c. 226, s. 13.)

Effect of Amendments. — The 1993 amendment, effective January 1, 1994, in subsection (c), at the beginning of the second sentence, substituted "Credit life, credit accident and health, and credit unemployment insurance, or any of them, may be offered but not required;" for "Decreasing term credit life insurance is optional, in an amount not exceeding the sum of the monthly installments payable under the loan and for a period not exceeding the term of the loan"; and in clause (iii) substituted "30" for "15" and inserted "or certificate" following "policy."

§ 24-17. (Effective October 1, 1994 — See editor's note) Misdemeanors.

A wilful or knowing violation of G.S. 24-12 through G.S. 24-16 is hereby made a Class 1 misdemeanor. (1971, c. 1229, s. 2; 1993, c. 539, s. 400; 1994, Ex. Sess., c. 24, s. 14(c).)

Editor's Note. — Session Laws 1993, c. 539, which amended this section, in s. 1359, as amended by Session Laws 1994, Extra Session, c. 24, s. 14(c), provides: "This act becomes effective October 1, 1994, and applies to offenses occurring on or after that date. Prosecutions for offenses committed before the effective date of this act are not abated or affected by this act, and the statutes that would be applicable but for this act remain applicable to those prosecutions."

Effect of Amendments. — The 1993 amendment, effective October 1, 1994, and applicable to offenses occurring on or after that date, substituted "Class 1 misdemeanor" for "misdemeanor punishable by a fine or imprisonment, or both, in the discretion of the court."

Chapter 25.

Uniform Commercial Code.

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25-1-105. Territorial application of the act; parties' power to choose applicable law.

Part 2. General Definitions and Principles of Interpretation.

25-1-201. General definitions.

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ARTICLE 1.

General Provisions.

PART 1.

SHORT TITLE, CONSTRUCTION, APPLICATION AND SUBJECT MATTER OF THE ACT.

§ 25-1-101. Short title.

Legal Periodicals. —

For note, "Real Estate Finance—Subordination Causes: North Carolina Subordinates Substance to Form—MCB Ltd. v. McGowan," see 23 Wake Forest L. Rev. 575 (1988).

For comment, "Is it a Sale or a Lease?: The Implications of Article 2A and Revised U.C.C. Section 1-201(37) in North Carolina," see 18 N.C. Cent. L.J. 187 (1989).

CASE NOTES

Cited in Wohlfahrt v. Schneider, 82 N.C. App. 69, 345 S.E.2d 448 (1986).

§ 25-1-102. Purposes; rules of construction; variation by agreement.

Legal Periodicals. — For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions, " see 8 Campbell L. Rev. 505 (1986).

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A contractual provision expanding seller's damages upon breach of the buyer will be upheld where the contractual provision is reasonable and in good faith. Martin v. Sheffer, 102 N.C. App. 802, 403 S.E.2d 555 (1991).

Parties were free to shape their remedies according to their particular needs, and an expansion of the seller's remedies beyond those specified in the Uniform Commercial Code to include specific performance was neither unreasonable nor unconscionable. Martin v. Sheffer, 102 N.C. App. 802, 403 S.E.2d 555 (1991).

Quoted in Stewart Office Suppliers, Inc. v. First Union Nat'l Bank, 97 N.C. App. 353, 388 S.E.2d 599 (1990).

§ 25-1-103. Supplementary general principles of law applicable.

CASE NOTES

Cited in Mulberry-Fairplains Water Ass'n v. Town of N. Wilkesboro, 105 N.C. App. 258, 412 S.E.2d 910 (1992).

§ 25-1-105. Territorial application of the act; parties' power to choose applicable law.

(1) Except as provided hereafter in this section, when a transaction bears a reasonable relation to this State and also to another state or nation the parties may agree that the law either of this State or of such other state or nation shall govern their rights and duties. Failing such agreement this chapter applies to transactions bearing an appropriate relation to this State.

(2) Where one of the following provisions of this Chapter specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law (including the conflict of laws rules) so specified:

Rights of creditors against sold goods. (G.S. 25-2-402).

Applicability of the article on bank deposits and collections. (G.S. 25-4-102).

Bulk transfers subject to the article on bulk transfers. (G.S. 25-6-102).

Applicability of the article on investment securities. (G.S. 25-8-106).

Perfection provisions of the article on secured transactions. (G.S. 25-9-103).

Governing law in the article on Funds Transfers. (G.S. 25-4A-507). (1965, c. 700, s. 1; 1975, c. 862, s. 1; 1993, c. 157, s. 2.)

Effect of Amendments. — The 1993 amendment, effective October 1, 1993, added the last sentence of subsection (2).

CASE NOTES

Purpose. — Purpose for adopting subsection (1), was to change North Carolina's adherence to lex loci contractus approach, which focuses on place of entering contract and on place of performance to determine which law governs contract disputes. Terry v. Pullman Trailmobile, 92 N.C. App. 687, 376 S.E.2d 47 (1989).

UCC provides its own choice of law rule, modifying the traditional place-of-contractor-performance rule previously applied in this state. Boudreau v. Baughman, 322 N.C. 331, 368 S.E.2d 849 (1988).

Section Changes Rigid Conflict of Laws Rules. —

This section modifies traditional conflict of law rules. Wohlfahrt v. Schneider, 82 N.C. App. 69, 345 S.E.2d 448 (1986).

The enactment of this section was intended to change this State's rigid choice of law rules with respect to transactions under the UCC. Boudreau v. Baughman, 322 N.C. 331, 368 S.E.2d 849 (1988).

Actions Based on Breach of Warranty, etc. —

A state's interest in enforcing warranties involves protection of its citizens from commercial movement of defective goods into that state. Boudreau v. Baughman, 322 N.C. 331, 368 S.E.2d 849 (1988).

UCC is silent on the meaning of the term "appropriate relation," leaving its interpretation to judicial decision. Boudreau v. Baughman, 322 N.C. 331, 368 S.E.2d 849 (1988).

"Appropriate Relation" Defined. — The North Carolina Supreme Court has interpreted "appropriate relation" to mean "most significant relationship." Boudreau v. Baughman, 322 N.C. 331, 368 S.E.2d 849 (1988).

Stipulation of Law, etc. —

Where the transaction bears a reasonable relation to more than one state, the UCC permits the parties to agree with respect to which state's law shall govern their rights and duties. Wohlfahrt v. Schneider, 82 N.C. App. 69, 345 S.E.2d 448 (1986).

Where the goods in question were located in Texas and performance was due in this State, the transaction bore a reasonable relationship to both states, and pursuant to the agreement of the parties, the substantive issues involved would be resolved by application of Texas law. Procedural issues, however, would be determined by application of the law of North Carolina. Wohlfahrt v. Schneider, 82 N.C. App. 69, 345 S.E.2d 448 (1986).

State with the Most Significant Relationship to Warranty Claims. — Where Florida was the place of sale, distribution, delivery, and use of the product, as well as the place of injury, in a products liability action, Florida was the state with the most significant relationship to the warranty claims. Boudreau v. Baughman, 322 N.C. 331, 368 S.E.2d 849 (1988).

Where plaintiff was severely injured while operating tractor-trailer and where plaintiff alleged that accident was caused by defective design, manufacture, and assembly of trailer, because sale and distribution occurred in North Carolina, trial court properly applied North Carolina law to plaintiff's breach of warranty claims. Terry v. Pullman Trailmobile, 92 N.C. App. 687, 376 S.E.2d 47 (1989).

Applied in Tolaram Fibers, Inc. v. Tandy Corp., 92 N.C. App. 713, 375 S.E.2d 673 (1989).

Cited in Tom Togs, Inc. v. Ben Elias Indus. Corp., 318 N.C. 361, 348 S.E.2d 782 (1986); Boudreau v. Baughman, 86 N.C. App. 165, 356 S.E.2d 907 (1987); Simms Inv. Co. v. E.F. Hutton & Co., 688 F. Supp. 193 (M.D.N.C. 1988).

§ 25-1-106. Remedies to be liberally administered.

Legal Periodicals. — For article, "The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory," see 23 Wake Forest L. Rev. 429 (1988).

PART 2.

GENERAL DEFINITIONS AND PRINCIPLES OF INTERPRETATION.

§ 25-1-201. General definitions.

Subject to additional definitions contained in the subsequent articles of this chapter which are applicable to specific articles or parts thereof, and unless the context otherwise requires, in this chapter:

(1) "Action" in the sense of a judicial proceeding includes recoupment, counterclaim, set-off, suit in equity and any other proceedings in which rights are determined.

(2) "Aggrieved party" means a party entitled to resort to a remedy.

(3) "Agreement" means the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in this chapter (G.S. 25-1-205 and 25-2-208). Whether an agreement has legal consequences is determined by the provisions of this chapter, if applicable; otherwise by the law of contracts (G.S. 25-1-103). (Compare "Contract.")

(4) "Bank" means any person engaged in the business of banking.

(5) "Bearer" means the person in possession of an instrument, document of title, or certificated security payable to bearer or indorsed in blank.

(6) "Bill of lading" means a document evidencing the receipt of goods for shipment issued by a person engaged in the business of transporting or forwarding goods, and includes an airbill. "Airbill" means a document serving for air transportation as a bill of lading does for marine or rail transportation, and includes an air consignment note or air waybill.

(7) "Branch" includes a separately incorporated foreign branch of a bank.

(8) "Burden of establishing a fact" means the burden of persuading the triers of fact that the existence of the fact is more probable than its nonexistence.

(9) "Buyer in ordinary course of business" means a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. All persons who sell minerals or the like (including oil and gas) at wellhead or minehead shall be deemed to be persons in the business of selling goods of that kind. "Buying" may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a preexisting contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

(10) "Conspicuous": A term or clause is conspicuous when it is so written that a reasonable person against whom it is to operate ought to have noticed it. A printed heading in capitals (as: NONNEGOTIABLE BILL OF LADING) is conspicuous. Language in the body of a form is "conspicuous" if it is in larger or other contrasting type or color. But in a telegram any stated term is "conspicuous." Whether a term or clause is "conspicuous" or not is for decision by the court.

(11) "Contract" means the total legal obligation which results from the parties' agreement as affected by this chapter and any other applicable rules of law. (Compare "Agreement.")

(12) "Creditor" includes a general creditor, a secured creditor, a lien creditor and any representative of creditors, including an assignee for the benefit of creditors, a trustee in bankruptcy, a receiver in equity and an executor or administrator of an insolvent debtor's or assignor's estate.

(13) "Defendant" includes a person in the position of defendant in a cross action or counterclaim.

(14) "Delivery" with respect to instruments, documents of title, chattel paper, or certificated securities means voluntary transfer of possession.

(15) "Document of title" includes bill of lading, dock warrant, dock receipt, warehouse receipt or order for the delivery of goods, and also any other document which in the regular course of business or financing is treated as adequately evidencing that the person in possession of it is entitled to receive, hold and dispose of the document and the goods it covers. To be a document of title a document must purport to be issued by or addressed to a bailee and purport to cover goods in the bailee's possession which are either identified or are fungible portions of an identified mass.

(16) "Fault" means wrongful act, omission or breach.

(17) "Fungible" with respect to goods or securities means goods or securities of which any unit is, by nature or usage of trade, the equivalent of any other like unit. Goods which are not fungible shall be deemed fungible for the purposes of this chapter to the extent that under a particular agreement or document unlike units are treated as equivalents.

(18) "Genuine" means free of forgery or counterfeiting.

(19) "Good faith" means honesty in fact in the conduct or transaction concerned.

(20) "Holder" means a person who is in possession of a document of title or an instrument or a certificated investment security drawn, issued, or indorsed to him or to his order or to bearer or in blank.

(21) To "honor" is to pay or to accept and pay, or where a credit so engages to purchase or discount a draft complying with the terms of the credit.

(22) "Insolvency proceedings" includes any assignment for the benefit of creditors or other proceedings intended to liquidate or rehabilitate the estate of the person involved.

(23) A person is "insolvent" who either has ceased to pay his debts in the ordinary course of business or cannot pay his debts as they become due or is insolvent within the meaning of the Federal Bankruptcy Law.

(24) "Money" means a medium of exchange authorized or adopted by a domestic or foreign government as a part of its currency.

(25) A person has "notice" of a fact when
(a) he has actual knowledge of it; or
(b) he has received a notice or notification of it; or
(c) from all the facts and circumstances known to him at the time in question he has reason to know that it exists.

A person "knows" or has "knowledge" of a fact when he has actual knowledge of it. "Discover" or "learn" or a word or phrase of similar import refers to knowledge rather than to reason to know. The time and circumstances under which a notice or notification may cease to be effective are not determined by this chapter.

(26) A person "notifies" or "gives" a notice or notification to another by taking such steps as may be reasonably re-

quired to inform the other in ordinary course whether or not such other actually comes to know of it. A person "receives" a notice or notification when

(a) it comes to his attention; or

(b) it is duly delivered at the place of business through which the contract was made or at any other place held out by him as the place for receipt of such communications.

(27) Notice, knowledge or a notice or notification received by an organization is effective for a particular transaction from the time when it is brought to the attention of the individual conducting that transaction, and in any event from the time when it would have been brought to his attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information.

(28) "Organization" includes a corporation, government or governmental subdivision or agency, business trust, estate, trust, partnership or association, two or more persons having a joint or common interest, or any other legal or commercial entity.

(29) "Party," as distinct from "third party," means a person who has engaged in a transaction or made an agreement within this chapter.

(30) "Person" includes an individual or an organization (See G.S. 25-1-102).

(31) "Presumption" or "presumed" means that the trier of fact must find the existence of the fact presumed unless and until evidence is introduced which would support a finding of its nonexistence.

(32) "Purchase" includes taking by sale, discount, negotiation, mortgage, pledge, lien, issue or re-issue, gift or any other voluntary transaction creating an interest in property.

(33) "Purchaser" means a person who takes by purchase.

(34) "Remedy" means any remedial right to which an aggrieved party is entitled with or without resort to a tribunal.

(35) "Representative" includes an agent, an officer of a corporation or association, and a trustee, executor or administrator of an estate, or any other person empowered to act for another.

(36) "Rights" includes remedies.

(37) "Security interest" means an interest in personal property or fixtures which secures payment or performance of an obligation. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (G.S. 25-2-401) is limited in effect to a reservation of a "security interest". The term also includes any interest of a buyer of accounts or chattel paper which is subject to Arti-

cle 9 of this Chapter. The special property interest of a buyer of goods on identification of those goods to a contract for sale under G.S. 25-2-401 is not a "security interest," but a buyer may also acquire a "security interest" by complying with Article 9 of this Chapter. Unless a consignment is intended as security, reservation of title thereunder is not a "security interest" but a consignment is in any event subject to the provisions on consignment sales (G.S. 25-2-326).

(a) Whether a transaction creates a lease or security interest is determined by the facts of each case; however, a transaction creates a security interest if:
  (i) The original term of the lease is equal to or greater than the remaining economic life of the goods, or
  (ii) The lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods, or
  (iii) The lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement, or
  (iv) The lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement.

(b) A transaction does not create a security interest merely because it provides that:
  (i) The present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into,
  (ii) The lessee assumes risk of loss of the goods, or agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs with respect to the goods,
  (iii) The lessee has an option to renew the lease or to become the owner of the goods,
  (iv) The lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed, or
  (v) The lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.

(c) For purposes of this subsection (37):
  (i) Additional consideration is not nominal if (i) when the option to renew the lease is granted to the lessee the rent is stated to be the fair market rent for the use of the goods for the term of the renewal determined at the time the option is to be performed, or (ii) when the option to become the

owner of the goods is granted to the lessee the price is stated to be the fair market value of the goods determined at the time the option is to be performed. Additional consideration is nominal if it is less than the lessee's reasonably predictable cost of performing under the lease agreement if the option is not exercised;

(ii) "Reasonably predictable" and "remaining economic life of the goods" are to be determined with reference to the facts and circumstances at the time the transaction is entered into; and

(iii) "Present value" means the amount as of a date certain of one or more sums payable in the future, discounted to the date certain. The discount is determined by the interest rate specified by the parties if the rate is not manifestly unreasonable at the time the transaction is entered into; otherwise, the discount is determined by a commercially reasonable rate that takes into account the facts and circumstances of each case at the time the transaction was entered into.

(38) "Send" in connection with any writing or notice means to deposit in the mail or deliver for transmission by any other usual means of communication with postage or cost of transmission provided for and properly addressed and in the case of an instrument to an address specified thereon or otherwise agreed, or if there be none to any address reasonable under the circumstances. The receipt of any writing or notice within the time at which it would have arrived if properly sent has the effect of a proper sending.

(39) "Signed" includes any symbol executed or adopted by a party with present intention to authenticate a writing.

(40) "Surety" includes guarantor.

(41) "Telegram" includes a message transmitted by radio, teletype, cable, any mechanical method of transmission, or the like.

(42) "Term" means that portion of an agreement which relates to a particular matter.

(43) "Unauthorized" signature or indorsement means one made without actual, implied or apparent authority and includes a forgery.

(44) "Value." Except as otherwise provided with respect to negotiable instruments and bank collections (G.S. 25-3-303, 25-4-208 and 25-4-209) a person gives "value" for rights if he acquires them

(a) in return for a binding commitment to extend credit or for the extension of immediately available credit whether or not drawn upon and whether or not a charge-back is provided for in the event of difficulties in collection; or

(b) as security for or in total or partial satisfaction of a pre-existing claim; or

(c) by accepting delivery pursuant to a pre-existing contract for purchase; or

(d) generally, in return for any consideration sufficient to support a simple contract.

(45) "Warehouse receipt" means a receipt issued by a person engaged in the business of storing goods for hire.

(46) "Written" or "writing" includes printing, typewriting or any other intentional reduction to tangible form. (1899, c. 733, ss. 25, 56, 191; Rev., ss. 2173, 2205, 2340, 3032; 1917, c. 37, ss. 4, 5, 58; 1919, c. 65, ss. 1, 10, 32, 42; c. 290; C.S., ss. 280, 283, 292, 314, 2976, 3005, 3037, 4037, 4044, 4046; 1941, c. 353, s. 22; G.S., s. 55-102; 1955, c. 1371, s. 2; 1961, c. 574; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, ss. 2, 3; 1989 (Reg. Sess., 1990), c. 1024, s. 8(a)-(c); 1993, c. 463, s. 2.)

Editor's Note. — The amendment by 1989 (Reg. Sess., 1990), c. 1024, s. 8(a)-(c) was a conforming amendment to the amendments to Article 8 of this Chapter that were adopted in 1989.

Effect of Amendments. — The 1989 (Reg. Sess., 1990) amendment, effective July 27, 1990, inserted "certificated" in subdivision (5); substituted "chattel paper, or certificated securities" for "chattel paper or securities" in subdivision (14), and in subdivision (20), substituted "a certificated investment" for "an investment," and inserted a comma following "issued."

The 1993 amendment, effective October 1, 1993, but not applicable to pending litigation, in subdivision (37) substituted "Article 9 of this Chapter" for "article 9" throughout the subsection, substituted "those goods" for "such goods" in the fourth sentence, deleted "lease or" preceding "consignment" in the fifth sentence; and substituted subdivisions (37)(a) through (37)(c) for the former sixth sentence.

Legal Periodicals. —

For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions," see 8 Campbell L. Rev. 505 (1986).

For article, "Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law," see 1987 Duke L.J. 1.

For article, "Public Filing and Personal Property Leases: Questions of Definition and Doctrine," see 22 Wake Forest L. Rev. 425 (1987).

For comment, "Is it a Sale or a Lease?: The Implications of Article 2A and Revised U.C.C. Section 1-201(37) in North Carolina," see 18 N.C. Cent. L.J. 187 (1989).

CASE NOTES

"Conspicuousness". —

Language on herbicide to the effect that seller made "no other express or implied warranty of fitness or merchantability or any other express or implied warranty," which was in darker and larger type than the other language on the label, was "conspicuous," as defined by subdivision (10) of this section, and served to effectively disclaim any implied warranties of merchantability or fitness. Tyson v. Ciba-Geigy Corp., 82 N.C. App. 626, 347 S.E.2d 473 (1986).

"Delivery". — Delivery of a deed or instrument to the named payee, subject to the control of the person delivering it or subject to an agreed condition, does not constitute delivery in the eyes of the law. State v. First Resort Properties, 81 N.C. App. 499, 344 S.E.2d 354 (1986).

"Rights". — The term "all rights" in an assignment included the contractual right of assignor to receive C.O.D. payment from defendant. Gunby v. Pilot Freight Carriers, Inc., 82 N.C. App. 427, 346 S.E.2d 188 (1986).

"Security Interest". —

Article 9 of this Chapter applies to a transaction intended to create a security interest, regardless of whom the certificate lists as the owner. Carter v. Holland (In re Carraway), 65 Bankr. 51 (Bankr. E.D.N.C. 1986).

Security Interest v. Lease. — Where a debtor could terminate her rental agreement for a VCR and a washing machine at any time with no further obligation to continue paying rent, the agreement was a "true" lease, not a security interest, under subdivision (37) of this section. In re Frady, 141 Bankr. 600 (Bankr. W.D.N.C. 1991).

"Warehouse Receipt". — "Household Goods Descriptive Inventory" was sufficient to constitute a warehouse receipt for purposes of holding defendant moving company responsible under Art. 7 for its actions as a warehouseman where the document listed each item picked up, its condition, the owner's name, the origin loading address, and was signed and dated by defendant's authorized agent and driver. Tate v. Action Moving & Storage, Inc., 95 N.C. App. 541, 383 S.E.2d 229 (1989), cert. denied, 326 N.C. 54, 389 S.E.2d 104 (1990).

Arbitration Is Neither an "Action" nor a "Judicial Proceeding." — By its terms the limitations period stated in § 25-2-725 applies only to an "action," which, under subsection (1) is a "judicial proceeding," and an arbitration is neither an "action" nor a "judicial proceeding," but a nonjudicial, out-of-court proceeding which makes an action or judicial proceeding unnecessary. In re Cameron, 91 N.C. App. 164, 370 S.E.2d 704 (1988).

Applied in Borg-Warner Acceptance Corp. v. Johnston, 97 N.C. App. 575, 389 S.E.2d 429 (1990); Crews v. W.A. Brown & Son, 106 N.C. App. 324, 416 S.E.2d 924 (1992).

Quoted in Branch Banking & Trust Co. v. Columbian Peanut Co., 649 F. Supp. 1116 (E.D.N.C. 1986); Stewart Office Suppliers, Inc. v. First Union Nat'l Bank, 97 N.C. App. 353, 388 S.E.2d 599 (1990); Holloway v. Wachovia Bank & Trust Co., 333 N.C. 94, 423 S.E.2d 752 (1992).

Stated in Whirlpool Corp. v. Dailey Constr., Inc., 110 N.C. App. 468, 429 S.E.2d 748 (1993).

Cited in Pillsbury Co. v. FCX, Inc., 62 Bankr. 315 (Bankr. E.D.N.C. 1986); Big B Transp., Inc. v. United States Ins. Group, 93 N.C. App. 233, 377 S.E.2d 278 (1989); Lincoln v. Grinstead, 94 N.C. App. 122, 379 S.E.2d 671 (1989); Alberti v. Manufactured Homes, Inc., 329 N.C. 727, 407 S.E.2d 819 (1991); Coastal Leasing Corp. v. O'Neal, 103 N.C. App. 230, 405 S.E.2d 208 (1991); Ace, Inc. v. Maynard, 108 N.C. App. 241, 423 S.E.2d 504 (1992); United States v. Currituck Grain, Inc., 6 F.3d 200 (4th Cir. 1993).

§ 25-1-203. Obligation of good faith.

Legal Periodicals. —

For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

For note, "Real Estate Finance—Subordination Causes: North Carolina Subordinates Substance to Form—MCB Ltd. v. McGowan," see 23 Wake Forest L. Rev. 575 (1988).

CASE NOTES

Cited in Carter v. Holland (In re Carraway), 65 Bankr. 51 (Bankr. E.D.N.C. 1986); Northwestern Bank v. NCF Fin. Corp., 88 N.C. App. 614, 365 S.E.2d 14 (1988).

§ 25-1-205. Course of dealing and usage of trade.

Legal Periodicals. — For article, "Stock Equipment for the Bargain in Fact: Trade Usage, Express Terms, and Consistency Under Section 1-205 of the Uniform Commercial Code," see 64 N.C.L. Rev. 777 (1986).

For article, "Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law," see 1987 Duke L.J. 1.

ARTICLE 2.

Sales.

PART 1.

SHORT TITLE, GENERAL CONSTRUCTION AND SUBJECT MATTER.

§ 25-2-101. Short title.

Legal Periodicals. —

For note on the conflict between the North Carolina Motor Vehicle Act and the UCC, see N.C.L. Rev. 1156 (1987).

For article, "The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory," see 23 Wake Forest L. Rev. 429 (1988).

For note, "Real Estate Finance—Subordination Causes: North Carolina Subordinates Substance to Form—MCB Ltd. v. McGowan," see 23 Wake Forest L. Rev. 575 (1988).

CASE NOTES

Applied in Coastal Leasing Corp. v. O'Neal, 103 N.C. App. 230, 405 S.E.2d 208 (1991).

Cited in Boudreau v. Baughman, 322 N.C. 331, 368 S.E.2d 849 (1988); Sunamerica Fin. Corp. v. Bonham, 328 N.C. 254, 400 S.E.2d 435 (1991).

§ 25-2-102. Scope; certain security and other transactions excluded from this article.

Legal Periodicals. —

For note, "Real Estate Finance—Subordination Causes: North Carolina Subordinates Substance to Form—MCB Ltd. v. McGowan," see 23 Wake Forest L. Rev. 575 (1988).

CASE NOTES

Article Not Applicable to True Lease. — Automobile lease agreement with an option to purchase at fair market value at the termination of the lease was a true lease, and not a future sale, and Article 2 was not applicable thereto. Alpiser v. Eagle Pontiac-GMC-Isuzu, Inc., 97 N.C. App. 610, 389 S.E.2d 293 (1990).

Because the sale of a mobile home is a "transaction in goods," it is subject to Article 2 of North Carolina's version of the Uniform Commercial Code. Alberti v. Manufactured Homes, Inc., 329 N.C. 727, 407 S.E.2d 819 (1991).

§ 25-2-103. Definitions and index of definitions.

Legal Periodicals. —

For note on North Carolina's automobile warranty legislation, see 66 N.C.L. Rev. 1080 (1988).

CASE NOTES

Right to assign legal rights is not exclusively governed by the UCC. Even if a party technically is not a "buyer" under the UCC, as long as it has a valid claim for breach of contract against defendant, the common law will permit its assignment. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

Privity Not Defined. — North Carolina's Uniform Commercial Code does not define "privity" and there are no governing Code provisions dispositive of this issue. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

Evidence of Good Faith Required by § 20-305 Held Sufficient. — Where manufacturer gave dealer at least a year's notice concerning the likelihood of cancellation, manufacturer treated dealer no differently than it did any of its other heavy-duty truck franchisees; and more importantly, where there was no evidence of dishonesty by manufacturer, the record was replete with evidence of manufacturer's good faith in cancelling its heavy-duty truck franchises with dealer under § 20-305. Carolina Truck & Body Co. v. GMC, 102 N.C. App. 262, 402 S.E.2d 135, cert. denied, 329 N.C. 266, 407 S.E.2d 831 (1991).

Manufacturer's withdrawal from the heavy duty truck market was in good faith as required by § 20-305(6). Good faith is defined in § 20-286(8b) as honest in fact and the observation of reasonable commercial standards of fair dealing in the trade as defined and interpreted in this section. Carolina Truck & Body Co. v. GMC, 102 N.C. App. 262, 402 S.E.2d 135, cert. denied, 329 N.C. 266, 407 S.E.2d 831 (1991).

Manufacturers of products other than self-propelled motor vehicles who are not in a direct contractual relationship with ultimate purchasers are, by implication, not "sellers" against whom purchasers may revoke acceptance. Alberti v. Manufactured Homes, Inc., 329 N.C. 727, 407 S.E.2d 819 (1991).

Applied in Coastal Leasing Corp. v. O'Neal, 103 N.C. App. 230, 405 S.E.2d 208 (1991); Crews v. W.A. Brown & Son, 106 N.C. App. 324, 416 S.E.2d 924 (1992).

Cited in Halprin v. Ford Motor Co., 107 N.C. App. 423, 420 S.E.2d 686 (1992).

§ 25-2-104. Definitions: "Merchant"; "between merchants"; "financing agency."

CASE NOTES

Applied in Coastal Leasing Corp. v. O'Neal, 103 N.C. App. 230, 405 S.E.2d 208 (1991).

Quoted in Goodman v. Wenco Mgt., 100 N.C. App. 108, 394 S.E.2d 832 (1990).

Cited in Ismael v. Goodman Toyota, 106 N.C. App. 421, 417 S.E.2d 290 (1992).

§ 25-2-105. Definitions: "Transferability"; "goods"; "future" goods; "lot"; "commercial unit."

Legal Periodicals. —

For note, "Real Estate Finance—Subordination Causes: North Carolina Subordinates Substance to Form—MCB Ltd. v. McGowan," see 23 Wake Forest L. Rev. 575 (1988).

CASE NOTES

Sale of spinal scanner was sale of goods; thus, sales transaction was governed by UCC. Muther-Ballenger v. Giffin Elec. Consultants, Inc., 100 N.C. App. 505, 397 S.E.2d 247 (1990).

The sale of potable water constituted a sale of goods under this article. Mulberry-Fairplains Water Ass'n v. Town of N. Wilkesboro, 105 N.C. App. 258, 412 S.E.2d 910 (1992).

Quoted in Goodman v. Wenco Mgt., 100 N.C. App. 108, 394 S.E.2d 832 (1990).

Cited in Buffaloe v. Hart, 114 N.C. App. 52, 441 S.E.2d 172 (1994).

§ 25-2-106. Definitions: "Contract"; "agreement"; "contract for sale"; "sale"; "present sale"; "layaway contract"; "conforming" to contract; "termination"; "cancellation."

(1) In this article unless the context otherwise requires "contract" and "agreement" are limited to those relating to the present or future sale of goods, including layaway contracts. "Contract for sale" includes both a present sale of goods and a contract to sell goods at a future time. A "sale" consists in the passing of title from the seller to the buyer for a price (G.S. 25-2-401). A "present sale" means a sale which is accomplished by the making of the contract. A "layaway contract" means any contract for the sale of goods in which the seller agrees with the purchaser, in consideration for the purchaser's payment of a deposit, down payment, or similar initial payment, to hold identified goods for future delivery upon the purchaser's payment of a specified additional amount, whether in installments or otherwise.

(2) Goods or conduct including any part of a performance are "conforming" or conform to the contract when they are in accordance with the obligations under the contract.

(3) "Termination" occurs when either party pursuant to a power created by agreement or law puts an end to the contract otherwise than for its breach. On "termination" all obligations which are still executory on both sides are discharged but any right based on prior breach or performance survives.

(4) "Cancellation" occurs when either party puts an end to the contract for breach by the other and its effect is the same as that of "termination" except that the cancelling party also retains any remedy for breach of the whole contract or any unperformed balance. (1965, c. 700, s. 1; 1967, c. 24, s. 6; 1993, c. 340, s. 1.)

Effect of Amendments. — The 1993 amendment, effective October 1, 1993, in the section catchline inserted "layaway contract"; in subsection (1) added at the end of the first sentence "including layaway contracts" and added the fifth sentence.

CASE NOTES

Lease Held Not a Future Sale. — Automobile lease agreement with an option to purchase at fair market value at the termination of the lease was a true lease, and not a future sale, and Article 2 was not applicable thereto. Alpiser v. Eagle Pontiac-GMC-Isuzu, Inc., 97 N.C. App. 610, 389 S.E.2d 293 (1990).

Stated in Stimpson Hosiery Mills, Inc. v. Pam Trading Corp., 98 N.C. App. 543, 392 S.E.2d 128 (1990).

§ 25-2-107. Goods to be severed from realty; recording.

CASE NOTES

Cited in Fisher v. Elmore, 802 F.2d 771 (4th Cir. 1986).

PART 2.

FORM, FORMATION AND READJUSTMENT OF CONTRACT.

§ 25-2-201. Formal requirements; statute of frauds.

Legal Periodicals. —

For article, "Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law," see 1987 Duke L.J. 1.

CASE NOTES

Goods Specially Manufactured for Buyer. — Where a lawn mower company orally agreed to purchase all of its requirements for footrest pads from defendant manufacturer, and plaintiff placed label on them and made them specifically for defendant, such contract for the sale of specially manufactured goods did not have to be in writing. Custom Molders, Inc. v. Roper Corp., 101 N.C. App. 606, 401 S.E.2d 96 (1991).

Check As a Writing. — A check may constitute a writing sufficient to satisfy the requirements of subsection (1) provided it (1) contains a writing sufficient to indicate a contract of sale between the parties; (2) is signed by the party or his authorized agent against whom enforcement is sought; and (3) states a quantity. Buffaloe v. Hart, 114 N.C. App. 52, 441 S.E.2d 172 (1994).

Personal check which specified the quantity of "five barns" on the "for" line, was signed by plaintiff, and contained an amount was not sufficient to satisfy this section as a writing because defendants, the parties against whom enforcement was sought, did not endorse the check. Buffaloe v. Hart, 114 N.C. App. 52, 441 S.E.2d 172 (1994).

Cited in Mulberry-Fairplains Water Ass'n v. Town of N. Wilkesboro, 105 N.C. App. 258, 412 S.E.2d 910 (1992).

§ 25-2-202. Final written expression; parol or extrinsic evidence.

Legal Periodicals. — For note discussing this section, in light of Fiber Indus., Inc. v. Salem Carpet Mills, Inc., 68 N.C. App. 690, 315 S.E.2d 735, cert. denied, 311 N.C. 754, 321 S.E.2d 132 (1984), see 21 Wake Forest L. Rev. 831 (1986).

CASE NOTES

Oral Modifications Made Subsequent to Written Contract. — Parol evidence rule bars admission of evidence of any contemporaneous oral agreements or any prior agreements which contradict terms of parties' final written agreement. Parol evidence rule would not bar plaintiff's evidence of oral modifications made subsequent to written contract. Muther-Ballenger v. Giffin Elec. Consultants, Inc., 100 N.C. App. 505, 397 S.E.2d 247 (1990).

Defendant's subsequent verbal warranties may modify prior written contract and written disclaimer. Muther-Ballenger v. Giffin Elec. Consultants, Inc., 100 N.C. App. 505, 397 S.E.2d 247 (1990).

Applied in Ace, Inc. v. Maynard, 108 N.C. App. 241, 423 S.E.2d 504 (1992).

§ 25-2-204. Formation in general.

Legal Periodicals. —

For note, "Real Estate Finance—Subordination Causes: North Carolina Subordinates Substance to Form—MCB Ltd. v. McGowan," see 23 Wake Forest L. Rev. 575 (1988).

CASE NOTES

Quoted in Southeastern Adhesives Co. v. Funder Am., Inc., 89 N.C. App. 438, 366 S.E.2d 505 (1988).

§ 25-2-206. Offer and acceptance in formation of contract.

CASE NOTES

Cited in Tom Togs, Inc. v. Ben Elias Indus. Corp., 318 N.C. 361, 348 S.E.2d 782 (1986); Fisher v. Elmore, 802 F.2d 771 (4th Cir. 1986).

§ 25-2-207. Additional terms in acceptance or confirmation.

Legal Periodicals. —

For article, "Restoring Peace in the Battle of the Forms: A Framework for Making Uniform Commercial Code Section 2-207 Work," see 69 N.C.L. Rev. 893 (1991).

CASE NOTES

Term which so drastically affects remedies available to buyer upon seller's breach must be considered material alteration when not explicitly negotiated by the parties. Therefore, plaintiff's attempt to add a disclaimer of warranties to the parties' contracts was ineffective. Southeastern Adhesives Co. v. Funder Am., Inc., 89 N.C. App. 438, 366 S.E.2d 505 (1988).

§ 25-2-208. Course of performance or practical construction.

Legal Periodicals. — For article, "Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law," see 1987 Duke L.J. 1.

CASE NOTES

Cited in Mulberry-Fairplains Water Ass'n v. Town of N. Wilkesboro, 105 N.C. App. 258, 412 S.E.2d 910 (1992).

§ 25-2-209. Modification, rescission and waiver.

CASE NOTES

Cited in Mulberry-Fairplains Water Ass'n v. Town of N. Wilkesboro, 105 N.C. App. 258, 412 S.E.2d 910 (1992).

§ 25-2-210. Delegation of performance; assignment of rights.

CASE NOTES

Assignment of Legal Rights. — Right to assign legal rights is not exclusively governed by the UCC. Even if a party technically is not a "buyer" under the UCC, as long as it has a valid claim for breach of contract against defendant, the common law will permit its assignment. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

Because buyer had a valid claim that it could assert by itself, plaintiff as assignee was entitled to assert its claim against defendant. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

PART 3.

GENERAL OBLIGATION AND CONSTRUCTION OF CONTRACT.

§ 25-2-302. Unconscionable contract or clause.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None

Purposes:

1. This section is intended to make it possible for the courts to police explicitly against the contracts or clauses which they find to be unconscionable. In the past such policing has been accomplished by adverse construction of language, by manipulation of the rules of offer and acceptance or by determinations that the clause is contrary to public policy or to the dominant purpose of the contract. This section is intended to allow the court to pass directly on the unconscionability of the contract or particular clause therein and to make a conclusion of law as to its unconscionability. The basic test is whether, in the

light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract. Subsection (2) makes it clear that it is proper for the court to hear evidence upon these questions. The principle is one of the prevention of oppression and unfair surprise (Cf. Campbell Soup Co. v. Wentz, 172 F.2d 80, 3d Cir. 1948) and not of disturbance of allocation of risks because of superior bargaining power. The underlying basis of this section is illustrated by the results in cases such as the following:

Kansas City Wholesale Grocery Co. v. Weber Packing Corporation, 93 Utah 414, 73 P.2d 1272 (1937), where a clause limiting time for complaints was held inapplicable to latent defects in a shipment of catsup which could be discovered only by microscopic analysis; Hardy v. General Motors Acceptance Corporation, 38 Ga.App. 463, 144 S.E.2d 327 (1928), holding that a disclaimer of warranty clause applied only to express warranties, thus letting in a fair implied warranty; Andrews Bros. v. Singer & Co. (1934 CA) 1 K.B. 17, holding that where a car with substantial mileage was delivered instead of a "new" car, a disclaimer of warranties, including those "implied," left unaffected an "express obligation" on the description, even though the Sale of Goods Act called such an implied warranty; New Prague Flouring Mill Co. v. G. A. Spears, 194 Iowa 417, 189 N.W. 815 (1922), holding that a clause permitting the seller, upon the buyer's failure to supply shipping instructions, to cancel, ship, or allow delivery date to be indefinitely postponed 30 days at a time by the inaction, does not indefinitely postpone the date of measuring damages for the buyer's breach, to the seller's advantage; and Kansas Flour Mills Co. v. Dirks, 100 Kan. 376, 164 P. 273 (1917), where under a similar clause in a rising market the court permitted the buyer to measure his damages for non-delivery at the end of only one 30 day postponement; Green v. Arcos, Ltd. (1931 CA) 47 T.L.R. 336, where a blanket clause prohibiting rejection of shipments by the buyer was restricted to apply to shipments where discrepancies represented merely mercantile variations; Meyer v. Packard Cleveland Motor Co., 106 Ohio St. 328, 140 N.E. 118 (1922), in which the court held that a "waiver" of all agreements not specified did not preclude implied warranty of fitness of a rebuilt dump truck for ordinary use as a dump truck; Austin Co. v. J. H. Tillman Co., 104 Or. 541, 209 P. 131 (1922), where a clause limiting the buyer's remedy to return was held to be applicable only if the seller had delivered a machine needed for a construction job which reasonably met the contract description; Bekkevold v. Potts, 173 Minn. 87, 216 N.W. 790, 59 A.L.R. 1164 (1927), refusing to allow warranty of fitness for purpose imposed by law to be negated by clause excluding all warranties "made" by the seller; Robert A. Munroe & Co. v. Meyer (1930) 2 K.B. 312, holding that the warranty of description overrides a clause reading "with all faults and defects" where adulterated meat not up to the contract description was delivered.

2. Under this section the court, in its discretion, may refuse to enforce the contract as a whole if it is permeated by the unconscionability, or it may strike any single clause or group of clauses which are so tainted or which are contrary to the essential purpose of the agreement, or it may simply limit unconscionable clauses so as to avoid unconscionable results.

3. The present section is addressed to the court, and the decision is to be made by it. The commercial evidence referred to in subsection (2) is for the court's consideration, not the jury's. Only the agreement which results from the court's action on these matters is to be submitted to the general triers of the facts.

Definitional Cross Reference:
"Contract". Section 1-201.

Editor's Note. — The official comment is set out above because it was not included under § 25-2-302 when the section was enacted in 1971.

Legal Periodicals. —
For article, "Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law," see 1987 Duke L.J. 1.

CASE NOTES

Purpose. — As the official comment to this statute makes clear, the purpose behind this section is to permit the courts to do openly what they have been doing for many years in a semi-covert way. Rite Color Chem. Co. v. Velvet Textile Co., 105 N.C. App. 14, 411 S.E.2d 645 (1992).

Unconscionability is an affirmative defense, and the party asserting it bears the burden of establishing it. Rite Color Chem. Co. v. Velvet Textile Co., 105 N.C. App. 14, 411 S.E.2d 645 (1992).

§ 25-2-305. Open price term.

Legal Periodicals. — For article, "Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law," see 1987 Duke L.J. 1.

For note, "Real Estate Finance—Subordination Causes: North Carolina Subordinates Substance to Form—MCB Ltd. v. McGowan," see 23 Wake Forest L. Rev. 575 (1988).

§ 25-2-306. Output, requirements and exclusive dealings.

Legal Periodicals. — For note, "Real Estate Finance—Subordination Causes: North Carolina Subordinates Substance to Form—MCB Ltd. v. McGowan," see 23 Wake Forest L. Rev. 575 (1988).

§ 25-2-308. Absence of specified place for delivery.

Legal Periodicals. — For article, "Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law," see 1987 Duke L.J. 1.

For note, "Real Estate Finance—Subordination Causes: North Carolina Subordinates Substance to Form—MCB Ltd. v. McGowan," see 23 Wake Forest L. Rev. 575 (1988).

§ 25-2-309. Absence of specific time provisions; notice of termination.

Legal Periodicals. — For article, "Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law," see 1987 Duke L.J. 1.

For note, "Real Estate Finance—Subordination Causes: North Carolina Subordinates Substance to Form—MCB Ltd. v. McGowan," see 23 Wake Forest L. Rev. 575 (1988).

CASE NOTES

Quoted in Foley v. L & L Int'l, Inc., 88 N.C. App. 710, 364 S.E.2d 733 (1988).

§ 25-2-311. Options and cooperation respecting performance.

CASE NOTES

Failure to Exercise Stock Option Within Reasonable Time. — Where plaintiffs could have availed themselves of the benefits of a stock option for over 17 months, which was more than a reasonable and seasonable amount of time within which to act, the trial judge properly concluded that plaintiffs had failed to exercise their option and could claim no ownership in the stock. Floto v. Pied Piper Resort, Inc., 96 N.C. App. 241, 385 S.E.2d 157, cert. denied, 326 N.C. 47, 389 S.E.2d 87 (1990).

§ 25-2-313. Express warranties by affirmation, promise, description, sample.

Cross References. — For the New Motor Vehicles Warranties Act, see § 20-351 et seq.

Legal Periodicals. —

For article, "Damages and Problems of Proof with Planted Nonconforming Seeds," see 9 Campbell L. Rev. 63 (1986).

For comment on tort reform, see 10 Campbell L. Rev. 439 (1988).

For comment, "Laying the Ghost of Reliance to Rest in Section 2-313 of the Uniform Commercial Code: An 'End-points' Analysis," see 28 Wake Forest L. Rev. 1065 (1993).

CASE NOTES

Basic obligation created by description of goods cannot be retracted. — A clause generally disclaiming all warranties, express or implied, cannot reduce seller's obligation with respect to such description. Muther-Ballenger v. Giffin Elec. Consultants, Inc., 100 N.C. App. 505, 397 S.E.2d 247 (1990).

A retailer may recover against the manufacturer for breach of warranty where a manufacturer's oral representations made directly to a retailer are intended to be communicated to remote buyers to induce them to buy a product. Alberti v. Manufactured Homes, Inc., 329 N.C. 727, 407 S.E.2d 819 (1991).

Warranty to Buyer and User. —

Where defendant obviously knew that buyer was seeking to obtain computer software on behalf of plaintiff, defendant made its express warranty to both plaintiff (buyer) and ultimate user of software in order to induce both parties to go through with the purchase of its software system. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

Question of Fact. —

The plaintiff's evidence was held to have made out a prima facie case that the defendant contracted or expressly warranted to provide the plaintiff with Number 2 milling wheat, a commodity with few defective kernels, and breached its obligation by supplying wheat of an inferior standard that contained a high percentage of defective kernels, breaching the implied warranty of merchantability and the implied warranty of fitness for a particular purpose; under the circumstances, whether these warranties were made or breached were questions of fact, not law. W.A. Davis Realty, Inc. v. Wakelon Agri-Products, Inc., 84 N.C. App. 97, 351 S.E.2d 816 (1987).

Whether defendant made or breached any express warranties that scanner would completely perform quality scanning of human spine is question of fact to be decided by trier of fact. Muther-Ballenger v. Giffin Elec. Consultants, Inc., 100 N.C. App. 505, 397 S.E.2d 247 (1990).

Issue of Material Fact as to Breach of Warranty. — Genuine issues of material fact existed as to owner's allegations of breach of express warranty; although manufacturer argued that it offered owner an express warranty which was rejected, architect and engineer for owner stated in his deposition that owner relied upon information and technical assistance by manufacturer in choosing the roof design and, therefore, owner's reliance would establish an express warranty by manufacturer. Westover Prods., Inc. v. Gateway Roofing Co., 94 N.C. App. 63, 380 S.E.2d 369 (1989).

Statement Held Mere Opinion. — Statement made by salesman to farmer that a certain herbicide would "do a good job" was a mere expression of opinion and did not create an express warranty. Tyson v. Ciba-Geigy Corp., 82 N.C. App. 626, 347 S.E.2d 473 (1986).

Statement Held to Be "Puffing". — Seller's advertisement that it sold "America's most complete line of reliable, economical gas heating appliances" was, under the Uniform Commercial Code, "a statement purporting to be merely the seller's opinion or commendation of the goods does not create warranty." Seller's statement that the heater was "reliable" could not be regarded by the buyers as part of the reason for their purchase; therefore, the language in seller's advertisement was mere puffing and not an express warranty. Warzynski v. Empire Comfort Sys., 102 N.C. App. 222, 401 S.E.2d 801 (1991).

Statement by Seller Creating Express Warranty. — In letter, president of defendant corporation stated, "We guarantee our programming with full return and refund privileges for the software and printer should our programming not perform as warranted." As a matter of law, this letter constituted an express warranty that the equipment would perform correctly. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

Where plaintiffs were informed by defendant's sales agent that their car was subject to a 12-month, 12,000 mile warranty, such a statement was certainly an affirmation of fact relating to the goods which became a basis of the bargain, and plaintiffs had no way of determining that such a warranty was limited to the manufacturer because there was no evidence that plaintiffs were told it was a manufacturer's warranty or that defendant excluded itself from the warranty and they were not even given a written copy of the warranty. The evidence supported the trial court's conclusion that defendant had made an express warranty to plaintiffs. Riley v. Ken Wilson Ford, Inc., 109 N.C. App. 163, 426 S.E.2d 717 (1993).

Breach of Express Warranty Not Shown. — In action for damages resulting from aircraft crash, plaintiffs-air passengers contended that they were third-party beneficiaries of an alleged express or implied warranty existing between aircraft manufacturer and preparer of negligently prepared and published aircraft instruction manual and aircraft pilot; however, plaintiffs did not allege that any relationship of the type required by this section existed at the time of the crash. Therefore, plaintiffs were not entitled to relief based upon their theories as a matter of law. Driver v. Burlington Aviation, Inc., 110 N.C. App. 519, 430 S.E.2d 476 (1993).

Applied in Russel v. Baity, 95 N.C. App. 422, 383 S.E.2d 217 (1989).

§ 25-2-314. Implied warranty: Merchantability; usage of trade.

Cross References. — For the New Motor Vehicles Warranties Act, see § 20-351 et seq. As to the Childhood Vaccine-Related Injury Compensation Program, see § 130A-422 et seq.

Legal Periodicals. —

For article, "Damages and Problems of Proof with Planted Nonconforming Seeds," see 9 Campbell L. Rev. 63 (1986).

For comment on tort reform, see 10 Campbell L. Rev. 439 (1988).

For survey, "Contract Warranties and Remedies: A Comprehensive Survey of the Creation, Modification and Exclusion of Contract Warranties and Remedies for Attorneys and Contracting Professionals," see 14 Campbell L. Rev. 323 (1993).

CASE NOTES

Retailer Entitled to Indemnification. — While restaurant's breach of warranty of merchantability was separate and distinct from seafood supplier's breach of the warranty of merchantability, in accordance with the jury instructions, only one such breach was necessary to cause patron's death as a result of scromboid fish poisoning. Accordingly, the restaurant, having committed the secondary breach, was entitled to indemnification from the primary obligor, the seafood supplier, as a matter of law. Simpson v. Hatteras Island Gallery Restaurant, Inc., 109 N.C. App. 314, 427 S.E.2d 131, cert. denied, 333 N.C. 792, 431 S.E.2d 27 (1993).

State and Federal Regulatory Acts Aid in Assessing Merchantability. —

Fact that hamburger complied with all state and federal regulations for ground beef did not establish that the meat was merchantable as a matter of law, but was only some evidence which the jury could consider in determining if the product was merchantable. Goodman v. Wenco Mgt., 100 N.C. App. 108, 394 S.E.2d 832 (1990).

Implied Warranty of Restaurant. — Generally, a restaurant makes an implied warranty that the food which it serves is fit for human consumption, even though the restaurant in the exercise of all possible care could not have discovered its unwholesome nature. Goodman v. Wenco Mgt., 100 N.C. App. 108, 394 S.E.2d 832 (1990).

Natural Substance in Food. — When a substance in food causes injury to a consumer of the food, it is not a bar to recovery for breach of applied warranties of merchantability against the seller that the substance was "natural" to the food, provided the substance is of such a size, quality or quantity, or the food has been so processed, or both, that the substance's presence should not reasonably have been anticipated by the consumer. Goodman v. Wenco Foods, Inc., 331 N.C. 1, 423 S.E.2d 444 (1992).

Statement Constituting Express Warranty. — In letter, president of defendant corporation stated, "We guarantee our programming with full return and refund privileges for the software and printer should our programming not perform as warranted." As a matter of law, this letter constituted an express warranty that the equipment would perform correctly. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

Privity Not Required. — Absence of contractual privity no longer bars a direct claim by an ultimate purchaser against the manufacturer for breach of the manufacturer's express warranty which is directed to the purchaser. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

Privity is not required when the theory is breach of an express warranty. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

Writing Must Be Conspicuous to Exclude Warranty. — To exclude implied warranty of fitness for particular purpose, writing must be conspicuous. To exclude warranty of merchantability, language must mention merchantability and be conspicuous. Muther-Ballenger v. Giffin Elec. Consultants, Inc., 100 N.C. App. 505, 397 S.E.2d 247 (1990).

Express Warranty Made to Plaintiff Buyer and Ultimate User. — Where defendant obviously knew that buyer was seeking to obtain computer software on behalf of plaintiff, defendant made its express warranty to both plaintiff (buyer) and ultimate user of software in order to induce both parties to go through with the purchase of its software system. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

What Plaintiff Must Show. —

Five elements must be proved in order to support a recovery under this section: (1) A merchant sold goods, (2) the goods were not "merchantable" at the time of sale, (3) the plaintiff was injured by such goods, (4) the defect or other condition amounting to a breach of the implied warranty of merchantability proximately caused the injury, and (5) the plaintiff so injured gave timely notice to the seller. Foyle ex rel. McMillan v. Lederle Labs., 674 F. Supp. 530 (E.D.N.C. 1987).

In accord with second paragraph in the main volume. See Chandler v. U-Line Corp., 91 N.C. App. 315, 371 S.E.2d 717, cert. denied, 323 N.C. 623, 374 S.E.2d 583 (1988).

Product Liability Act Available as Defense. — The legislature intended that § 99B-2(a), a part of the Products Liability Act, be available as a defense to actions for breach of an implied warranty of merchantability brought under the UCC. Morrison v. Sears, Roebuck & Co., 319 N.C. 298, 354 S.E.2d 495 (1987).

Where defendant distributors acquired and sold potato whitener in sealed cartons and there was no evidence that they damaged, mishandled or otherwise altered the product, and defendant food service obtained the product in sealed jars and no evidence demonstrated that they damaged or altered the product, § 99B-2(a) barred recovery on plaintiff's implied warranty claims against food service, (plaintiff's employer) and the distributors. Sutton v. Major Prods. Co., 91 N.C. App. 610, 372 S.E.2d 897 (1988).

Compliance of vaccine manufacturer with Food and Drug Administration standards did not dictate a per se finding that DPT vaccine was "merchantable" at the time of sale. Foyle ex rel. McMillan v. Lederle Labs., 674 F. Supp. 530 (E.D.N.C. 1987). As to vaccine-related injuries, see now § 130A-422 et seq.

Sale of Food or Drink. — The sale of food or drink constitutes a sale of goods, and a warranty of merchantability is implied in all contracts for the sale of goods. Simpson v. Hatteras Island Gallery Restaurant, Inc., 109 N.C. App. 314, 427 S.E.2d 131, cert. denied, 333 N.C. 792, 431 S.E.2d 27 (1993).

Unmerchantable Automobile. — When plaintiff's evidence indicated he had returned the car to defendant for repairs on at least six occasions during the first six months of his ownership, and that plaintiff had driven the car a total of only 700 miles before he was informed the car was not repairable, plaintiff's evidence demonstrated that the car was unfit for its ordinary purpose at the time of the sale and was therefore "unmerchantable" at that time. Ismael v. Goodman Toyota, 106 N.C. App. 421, 417 S.E.2d 290 (1992).

Merchantability Held Question for Jury. —

The plaintiff's evidence was held to have made out a prima facie case that the defendant contracted or expressly warranted to provide the plaintiff with Number 2 milling wheat, a commodity with few defective kernels, and breached its obligation by supplying wheat of an inferior standard that contained a high percentage of defective kernels, breaching the implied warranty of merchantability and the implied warranty of fitness for a particular purpose; under the circumstances, whether these warranties were made or breached were questions of fact, not law. W.A. Davis Realty, Inc. v. Wakelon Agri-Products, Inc., 84 N.C. App. 97, 351 S.E.2d 816 (1987).

Expectation of Defect Held Question for Jury. — Whether the defect should reasonably be expected by the ordinary consumer is usually a question for the jury. Simpson v. Hatteras Island Gallery Restaurant, Inc., 109 N.C. App. 314, 427 S.E.2d 131, cert. denied, 333 N.C. 792, 431 S.E.2d 27 (1993).

No Right of Contribution for Third Party. — Claim for relief, based on a breach of implied warranty, gave rise to no right of contribution on the part of third party plaintiff, because it sounded in contract and not in tort. Holland v. Edgerton, 85 N.C. App. 567, 355 S.E.2d 514 (1987).

No Implied Warranty of Fitness for Particular Purpose Applied when Manufactured to Buyer's Specification. — Since plaintiff properly manufactured the urea resin to defendant's specifications, no implied warranty of fitness for a particular purpose arises. Though no implied warranty of fitness for a particular purpose arises here because defendant provided plaintiff with the specifications to manufacture the resin, the implied warranty of merchantability exists in any sales contract where the seller is a "merchant with respect to [the] goods" sold. Southeastern Adhesives Co. v. Funder Am., Inc., 89 N.C. App. 438, 366 S.E.2d 505 (1988).

No Issue of Material Fact as to Breach of Implied Warranties. — There were no genuine issues of material fact for supplier's negligence and breach of implied warranty of merchantability where supplier provided neither technical assistance nor installation training and instruction to subcontractor, and no evidence on appeal showed that manufacturer's materials were in any way defective. Westover Prods., Inc. v. Gateway Roofing Co., 94 N.C. App. 63, 380 S.E.2d 375 (1989).

Applied in Cato Equip. Co. v. Matthews, 91 N.C. App. 546, 372 S.E.2d 872 (1988); Russel v. Baity, 95 N.C. App. 422, 383 S.E.2d 217 (1989); Lormic Dev. Corp. v. North Am. Roofing Co., 95 N.C. App. 704, 383 S.E.2d 694 (1989).

Quoted in Westover Prods., Inc. v. Gateway Roofing Co., 94 N.C. App. 63, 380 S.E.2d 369 (1989); Ace, Inc. v. Maynard, 108 N.C. App. 241, 423 S.E.2d 504 (1992).

Cited in Stiles v. Chloride, Inc., 668 F. Supp. 505 (W.D.N.C. 1987); Ferguson v. Williams, 92 N.C. App. 336, 374 S.E.2d 438 (1988); Gregory v. Atrium Door & Window Co., 106 N.C. App. 142, 415 S.E.2d 574 (1992).

§ 25-2-315. Implied warranty: Fitness for particular purpose.

Cross References. — For the New Motor Vehicles Warranties Act, see § 20-351 et seq. As to the Childhood Vaccine-Related Injury Compensation Program, see § 130A-422 et seq.

Legal Periodicals. —

For article, "Damages and Problems of Proof with Planted Nonconforming Seeds," see 9 Campbell L. Rev. 63 (1986).

For note, "The Legal Liability of Blood Donor Services and Transfusion Providers in the Wake of the AIDS Crisis," see 290 N.C. Cent. L.J. 20 (1992).

For survey, "Contract Warranties and Remedies: A Comprehensive Survey of the Creation, Modification and Exclusion of Contract Warranties and Remedies for Attorneys and Contracting Professionals," see 14 Campbell L. Rev. 323 (1993).

CASE NOTES

Inapplicable to Lease. — Agreement between the parties providing for the lease of golf carts, which agreement was designated a lease on its face and was for a fixed term of 48 months, also provided the lessee with the option to purchase the golf carts. This purchase option indicated that the parties intended to engage in a true lease, not a disguised sale because the option price was the equipment's fair market value, and the purchase option was intended to approximate the depreciated fair market value of the golf carts. The agreement was therefore a true lease, making Article 2 inapplicable. Beau Rivage Plantation, Inc. v. Melex USA, Inc., 112 N.C. App. 446, 436 S.E.2d 152 (1993).

Abrogation of Privity Requirement in Certain Claims. — Chapter 99B (products liability) expressly abrogates the privity requirement in certain claims based upon implied warranty. However, outside the exceptions created by Chapter 99B, the general rule is that privity is required to assert a claim for breach of an implied warranty involving only economic loss. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

Writing Must Be Conspicuous to Exclude Warranty. — To exclude implied warranty of fitness for particular purpose, writing must be conspicuous. To exclude warranty of merchantability, language must mention merchantability and be conspicuous. Muther-Ballenger v. Giffin Elec. Consultants, Inc., 100 N.C. App. 505, 397 S.E.2d 247 (1990).

Question of Fact. — The plaintiff's evidence was held to have made out a prima facie case that the defendant contracted or expressly warranted to provide the plaintiff with Number 2 milling wheat, a commodity with few defective kernels, and breached its obligation by supplying wheat of an inferior standard that contained a high percentage of defective kernels, breaching the implied warranty of merchantability and the implied warranty of fitness for a particular purpose; under the circumstances, whether these warranties were made or breached were questions of fact, not law. W.A. Davis Realty, Inc. v. Wakelon Agri-Products, Inc., 84 N.C. App. 97, 351 S.E.2d 816 (1987).

Sale of Camper with Defective Motor Held Breach. — Defendants made and breached the implied warranty of fitness, where they sold a camper to plaintiffs with a motor which was warranted as a new motor but failed to perform and had to be replaced one month after purchase. Whitehurst v. Crisp R.V. Ctr., Inc., 86 N.C. App. 521, 358 S.E.2d 542 (1987).

Purpose of Vaccine. — DPT vaccine had the ordinary purpose of preventing the contraction of disease. There was no particular purpose, native to the plaintiff's position, that would implicate an implied warranty for a particular purpose. Foyle ex rel. McMillan v. Lederle Labs., 674 F. Supp. 530 (E.D.N.C. 1987).

As to vaccine-related injury, see now § 130A-422 et seq.

Evidence Held to Show Implied Warranty. — Evidence was sufficient for jury to find that salesman, consulted by farmer with regard to the no-till cultivation of soybeans, made an implied warranty relating to the fitness of a certain herbicide for plaintiff's purpose and that this warranty was breached. Tyson v. Ciba-Geigy Corp., 82 N.C. App. 626, 347 S.E.2d 473 (1986).

No Implied Warranty of Fitness for Particular Purpose Applied When Manufactured to Buyer's Specifications. — Since plaintiff properly manufactured the urea resin to defendant's specifications, no implied warranty of fitness for a particular purpose arises. Though no implied warranty of fitness for a particular purpose arises here because defendant provided plaintiff with the specifications to manufacture the resin, the implied warranty of merchantability exists in any sales contract where the seller is a "merchant with respect to [the] goods" sold. Southeastern Adhesives Co. v. Funder Am., Inc., 89 N.C. App. 438, 366 S.E.2d 505 (1988).

Supplier Not Liable Where Owner Relied on Manufacturer. — There was no genuine issue of material fact as to breach of implied warranty of particular purpose where owner did not rely in any way upon supplier's advice in owner's selection of the roofing system, but rather, it was manufacturer whom owner relied upon. Westover Prods., Inc. v. Gateway Roofing Co., 94 N.C. App. 63, 380 S.E.2d 375 (1989).

Cited in Ramsey Prods. Corp. v. Morbark Indus., Inc., 823 F.2d 798 (4th Cir. 1987); Ferguson v. Williams, 92 N.C. App. 336, 374 S.E.2d 438 (1988); Gregory v. Atrium Door & Window Co., 106 N.C. App. 142, 415 S.E.2d 574 (1992); Driver v. Burlington Aviation, Inc., 110 N.C. App. 519, 430 S.E.2d 476 (1993).

§ 25-2-316. Exclusion or modification of warranties.

Legal Periodicals. —

For article, "Damages and Problems of Proof with Planted Nonconforming Seeds," see 9 Campbell L. Rev. 63 (1986).

CASE NOTES

Writing Must Be Conspicuous to Exclude Warranty. — To exclude implied warranty of fitness for particular purpose, writing must be conspicuous. To exclude warranty of merchantability, language must mention merchantability and be conspicuous. Muther-Ballenger v. Giffin Elec. Consultants, Inc., 100 N.C. App. 505, 397 S.E.2d 247 (1990).

Rejection of Express Warranty Did Not Act as Waiver. — Manufacturer's offer and owner's rejection of a five-year express warranty of the roof installed for owner did not fall within the exclusion provisions of this section; therefore, the offer and rejection of the express warranty did not automatically waive the implied warranty of merchantability. Westover Prods., Inc. v. Gateway Roofing Co., 94 N.C. App. 63, 380 S.E.2d 369 (1989).

Clause Generally Disclaiming All Warranties Cannot Reduce Seller's Obligation. — Basic obligation created by description of goods cannot be retracted. A clause generally disclaiming all warranties, express or implied, cannot reduce seller's obligation with respect to such description. Muther-Ballenger v. Giffin Elec. Consultants, Inc., 100 N.C. App. 505, 397 S.E.2d 247 (1990).

Defendant's subsequent verbal warranties may modify prior written contract and written disclaimer. Muther-Ballenger v. Giffin Elec. Consultants, Inc., 100 N.C. App. 505, 397 S.E.2d 247 (1990).

Material Question of Fact Whether Quotation and Service Agreement Were One or Two Contracts. — Quotation and service agreement were on separate pieces of paper; each document contained a separate executory section, and each document could be read as an entire agreement in itself. There was no language of disclaimer in quotation; the only disclaimer appeared on service agreement. Thus there was a material question of fact as to whether the quotation and the service contract constituted either one contract for sale of goods or two contracts, one for sale of goods and one for sale of services. Muther-Ballenger v. Giffin Elec. Consultants, Inc., 100 N.C. App. 505, 397 S.E.2d 247 (1990).

Language Held Effective Disclaimer. — Language on herbicide to the effect that seller made "no other express or implied warranty of fitness or merchantability or any other express or implied warranty," which was in darker and larger type than the other language on the label, was "conspicuous," as defined by § 25-1-201(10), and served to effectively disclaim any implied warranties of merchantability or fitness. Tyson v. Ciba-Geigy Corp., 82 N.C. App. 626, 347 S.E.2d 473 (1986).

Since plaintiff properly manufactured the urea resin to defendant's specifications, no implied warranty of fitness for a particular purpose arises. Though no implied warranty of fitness for a particular purpose arises here because defendant provided plaintiff with the specifications to manufacture the resin, the implied warranty of merchantability exists in any sales contract where the seller is a "merchant with respect to [the] goods" sold. Southeastern Adhesives Co. v. Funder Am., Inc., 89 N.C. App. 438, 366 S.E.2d 505 (1988).

Applied in Cato Equip. Co. v. Matthews, 91 N.C. App. 546, 372 S.E.2d 872 (1988); Coastal Leasing Corp. v. O'Neal, 103 N.C. App. 230, 405 S.E.2d 208 (1991); Ace, Inc. v. Maynard, 108 N.C. App. 241, 423 S.E.2d 504 (1992).

Cited in Ramsey Prods. Corp. v. Morbark Indus., Inc., 823 F.2d 798 (4th Cir. 1987); Goodman v. Wenco Mgt., 100 N.C. App. 108, 394 S.E.2d 832 (1990); Ismael v. Goodman Toyota, 106 N.C. App. 421, 417 S.E.2d 290 (1992).

§ 25-2-318. Third party beneficiaries of warranties express or implied.

CASE NOTES

Church Member Not in Privity of Contract. — Church member, who was trapped inside the church's walk-in freezer and suffered severe frostbite, could not be considered as a member of the church's "family" or "household" or a guest in the church's "home," for the purpose of maintaining a products liability action based on a breach of seller's express and implied warranties without establishing privity of contract. Crews v. W.A. Brown & Son, 106 N.C. App. 324, 416 S.E.2d 924 (1992).

Privity Requirement Governed by Case Law. —

This section eliminates the need for privity when a natural person is suing to recover for personal injuries, but is silent as to whether privity is required in other contexts. Courts will turn to case law to determine whether privity is required between buyers and sellers. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

Cited in Boudreau v. Baughman, 86 N.C. App. 165, 356 S.E.2d 907 (1987); Driver v. Burlington Aviation, Inc., 110 N.C. App. 519, 430 S.E.2d 476 (1993).

§ 25-2-326. Sale on approval and sale or return; consignment sales and rights of creditors.

Legal Periodicals. —

For article "Public Filing and Personal Property Leases: Questions of Definition and Doctrine," see 22 Wake Forest L. Rev. 425 (1987).

PART 4.

TITLE, CREDITORS AND GOOD FAITH PURCHASERS.

§ 25-2-401. Passing of title; reservation for security; limited application of this section.

Legal Periodicals. — For note on the conflict between the North Carolina Motor Vehicle Act and the UCC, see 65 N.C.L. Rev. 1156 (1987).

CASE NOTES

Cited in Fisher v. Elmore, 802 F.2d 771 (4th Cir. 1986).

§ 25-2-403. Power to transfer; good faith purchase of goods; "entrusting."

Legal Periodicals. — For note on the conflict between the North Carolina Motor Vehicle Act and the UCC, see 65 N.C.L. Rev. 1156 (1987).

For comment, "Entrustment Under U.C.C. Section 2-403 and Its Implications for Article 9," see 9 Campbell L. Rev. 407 (1987).

For note, "Stolen Artwork: Deciding Ownership is no Pretty Picture," see 1993 Duke L.J. 337.

CASE NOTES

Cited in Pillsbury Co. v. FCX, Inc., 62 Bankr. 315 (Bankr. E.D.N.C. 1986).

PART 5.

PERFORMANCE.

§ 25-2-501. Insurable interest in goods; manner of identification of goods.

CASE NOTES

Cited in Fisher v. Elmore, 802 F.2d 771 (4th Cir. 1986).

PART 6.

BREACH, REPUDIATION AND EXCUSE.

§ 25-2-601. Buyer's rights on improper delivery.

CASE NOTES

Cited in Watson v. Graf Bae Farm, Inc., 99 N.C. App. 210, 392 S.E.2d 651 (1990).

§ 25-2-602. Manner and effect of rightful rejection.

Legal Periodicals. — For note on North Carolina's automobile warranty legislation, see 66 N.C.L. Rev. 1080 (1988).

CASE NOTES

Cited in Watson v. Graf Bae Farm, Inc., 99 N.C. App. 210, 392 S.E.2d 651 (1990).

§ 25-2-603. Merchant buyer's duties as to rightfully rejected goods.

CASE NOTES

Cited in Alberti v. Manufactured Homes, Inc., 329 N.C. 727, 407 S.E.2d 819 (1991).

§ 25-2-604. Buyer's options as to salvage of rightfully rejected goods.

CASE NOTES

Cited in Alberti v. Manufactured Homes, Inc., 329 N.C. 727, 407 S.E.2d 819 (1991).

§ 25-2-607. Effect of acceptance; notice of breach; burden of establishing breach after acceptance; notice of claim or litigation to person answerable over.

Legal Periodicals. —

For article on notice of breach in nonprivity contexts, see 66 N.C.L. Rev. 107 (1987).

CASE NOTES

But Does Not Bar Action for Breach of Warranty. —

A buyer who accepts goods must pay the seller the contract price, but can sue the seller for breach of warranty. Stimpson Hosiery Mills, Inc. v. Pam Trading Corp., 98 N.C. App. 543, 392 S.E.2d 128 (1990).

Policy behind Subsection (3)(a) Notice Requirement. —

The most important policy behind the notice requirement of this section is to allow the seller the opportunity to cure the breach and minimize its damages. Riley v. Ken Wilson Ford, Inc., 109 N.C. App. 163, 426 S.E.2d 717 (1993).

Defendant breached its express warranty to plaintiffs when it refused to further repair plaintiffs' car only 10 months after purchase and within the 12 month warranty period. Riley v. Ken Wilson Ford, Inc., 109 N.C. App. 163, 426 S.E.2d 717 (1993).

Cited in Whitehurst v. Crisp R.V. Ctr., Inc., 86 N.C. App. 521, 358 S.E.2d 542 (1987); Halprin v. Ford Motor Co., 107 N.C. App. 423, 420 S.E.2d 686 (1992).

§ 25-2-608. Revocation of acceptance in whole or in part.

Legal Periodicals. —

For note on North Carolina's automobile warranty legislation, see 66 N.C.L. Rev. 1080 (1988).

CASE NOTES

Subsection (2) of this statute is for the protection of sellers where the buyer allows the goods to deteriorate, creating the risk that the alleged defect was caused or aggravated by the buyer's action or inaction. Roy Burt Enters., Inc. v. Marsh, 328 N.C. 262, 400 S.E.2d 425 (1991).

A tender of the goods to the seller is not required in order to revoke acceptance. Roy Burt Enters., Inc. v. Marsh, 328 N.C. 262, 400 S.E.2d 425 (1991).

Issue Is Whether Goods Have Nonconformity Which Substantially Impairs Value to Buyer. — The threshold issue is whether the goods have a nonconformity which substantially impairs their value to the buyer. Resolution of this factual issue requires the application of a two-part test which considers both the buyer's subjective reaction to the alleged defect (taking into account the buyer's needs, circumstances, and reaction to the nonconformity) and the objective reasonableness of this reaction (taking into account the goods' market value, reliability, safety, and usefulness for purposes for which similar goods are used, including efficiency of operation, cost of repair of nonconformities, and the seller's ability or willingness to seasonably cure the nonconformity). Allen v. Rouse Toyota Jeep, Inc., 100 N.C. App. 737, 398 S.E.2d 64 (1990).

What Buyer Must Show. — In order for the buyer to show that his revocation was justifiable, the following four elements must be proved: (1) that the goods contained a nonconformity that substantially impaired their value to him; (2) that he either accepted the goods knowing of the nonconformity but reasonably assuming that it would be cured, or that he accepted the goods not knowing of the nonconformity due to the difficulty of discovery or reasonable assurances from the seller that the goods were conforming; (3) that revocation occurred within a reasonable time after he discovered or should have discovered the defect; and (4) that he has notified the seller of his revocation. Harrington Mfg. Co. v. Logan Tontz Co., 40 N.C. App. 496, 253 S.E.2d 282, cert. denied, 297 N.C. 454, 256 S.E.2d 806 (1979); Warren v. Guttanit, Inc., 69 N.C. App. 103, 317 S.E.2d 5 (1984); Cato Equip. Co. v. Matthews, 91 N.C. App. 546, 372 S.E.2d 872 (1988).

The proper test for buyer reaction to be applied is a "personalized objective test," or how a reasonable person would react if in the buyer's position. Allen v. Rouse Toyota Jeep, Inc., 100 N.C. App. 737, 398 S.E.2d 64 (1990).

Manufacturers of products other than self-propelled motor vehicles who are not in a direct contractual relationship with ultimate purchasers are, by implication, not "sellers" against whom purchasers may revoke acceptance. Alberti v. Manufactured Homes, Inc., 329 N.C. 727, 407 S.E.2d 819 (1991).

Manufacturers of Mobile Homes. — Except in the case of self-propelled vehicles for which the statute expressly provides otherwise, the existence of a direct contractual relationship between buyer and seller is generally a prerequisite to the right of a buyer to revoke acceptance against the seller; therefore, plaintiff mobile home buyers were not entitled to revoke acceptance of the mobile home against defendant manufacturer. Alberti v. Manufactured Homes, Inc., 329 N.C. 727, 407 S.E.2d 819 (1991).

Compliance With Statutory Prerequisites Involves Questions of Fact. — Compliance with each of the statutory prerequisites to revocation involves questions of fact, not matters of law for the trial court. Allen v. Rouse Toyota Jeep, Inc., 100 N.C. App. 737, 398 S.E.2d 64 (1990).

Plaintiffs never notified defendant of their revocation of acceptance of defective automobile; therefore, plaintiffs were not entitled to damages under § 25-2-711. Instead, plaintiffs were only entitled to damages for breach of warranty as set forth in § 25-2-714. Riley v. Ken Wilson Ford, Inc., 109 N.C. App. 163, 426 S.E.2d 717 (1993).

Delay in Revocation to See If Assurances Have Been Met Is Not Per Se Unreasonable. — When the seller has made repeated assurances that the defect can be and will be cured, a delay in revocation to see if these assurances are met and use of the product is not per se unreasonable. Allen v. Rouse Toyota Jeep, Inc., 100 N.C. App. 737, 398 S.E.2d 64 (1990).

Timeliness of Revocation Is Question of Law When Facts Undisputed. — Although whether the acceptance of a purchase has been timely revoked is usually a question of fact, when the facts are undisputed and only one inference can be drawn from them it is a question of law for the court. Whitehurst v. Crisp R.V. Ctr., Inc., 86 N.C. App. 521, 358 S.E.2d 542 (1987).

Facts Sufficient to Justify Revocation. — A crankshaft which was cracked and caused damage to other parts of the engine substantially impaired the crankshaft's value to buyer and his revocation was justifiable. Cato Equip. Co. v. Matthews, 91 N.C. App. 546, 372 S.E.2d 872 (1988).

Defects existing in an automobile substantially impaired its value to the plaintiffs so that they were entitled to revoke acceptance. Riley v. Ken Wilson Ford, Inc., 109 N.C. App. 163, 426 S.E.2d 717 (1993).

Mere malfunction does not prove existence of defective material or workmanship. Massey-Ferguson Credit Corp. v. Webber, 841 F.2d 1245 (4th Cir. 1988), aff'd, 885 F.2d 865 (4th Cir. 1989).

Recovery upon Revocation or Rejection. —

A buyer who revokes his acceptance has the same rights and duties with regard to the goods involved as if he had rejected them. Cato Equip. Co. v. Mathews, 91 N.C. App. 546, 372 S.E.2d 872 (1988).

Cited in Wohlfahrt v. Schneider, 82 N.C. App. 69, 345 S.E.2d 448 (1986); Morris v. Bailey, 86 N.C. App. 378, 358 S.E.2d 120 (1987).

§ 25-2-610. Anticipatory repudiation.

Legal Periodicals. —

For article, "The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory," see 23 Wake Forest L. Rev. 429 (1988).

§ 25-2-612. "Installment contract"; breach.

Legal Periodicals. — For article, "The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory," see 23 Wake Forest L. Rev. 429 (1988).

§ 25-2-615. Excuse by failure of presupposed conditions.

Legal Periodicals. —

For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

For article, "Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law," see 1987 Duke L.J. 1.

PART 7.

REMEDIES.

§ 25-2-702. Seller's remedies on discovery of buyer's insolvency.

CASE NOTES

Priority of Floating Lien over Rights of Reclaiming Sellers. — A floating lien on inventory, assuming the lienholder is a "good faith purchaser," has priority over the rights of reclaiming sellers. Pillsbury Co. v. FCX, Inc., 62 Bankr. 315 (Bankr. E.D.N.C. 1986).

The rights of a reclaiming seller under this section have a lower status than those of a junior lien creditor, and consequently a reclaiming seller's rights have no value if the floating lien, to which those rights are inferior, exceeds the value of the lienholder's collateral. Pillsbury Co. v. FCX, Inc., 62 Bankr. 315 (Bankr. E.D.N.C. 1986).

In bankruptcy proceedings, reclaiming sellers are not automatically entitled to an administrative priority or substitute lien if their reclamation rights are frustrated by the presence of a prior lien. The right to an administrative priority or substitute lien exists only if there also exists a right to reclaim. Pillsbury Co. v. FCX, Inc., 62 Bankr. 315 (Bankr. E.D.N.C. 1986).

But rights of reclaiming sellers are not automatically extinguished simply because those rights may be subject to the rights of a secured creditor. Pillsbury Co. v. FCX, Inc., 62 Bankr. 315 (Bankr. E.D.N.C. 1986).

§ 25-2-703. Seller's remedies in general.

Legal Periodicals. —

For article, "The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory," see 23 Wake Forest L. Rev. 429 (1988).

§ 25-2-706. Seller's resale including contract for resale.

Legal Periodicals. — For article, "The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory," see 23 Wake Forest L. Rev. 429 (1988).

CASE NOTES

Cited in Tom Togs, Inc. v. Ben Elias Indus. Corp., 318 N.C. 361, 348 S.E.2d 782 (1986); Alberti v. Manufactured Homes, Inc., 329 N.C. 727, 407 S.E.2d 819 (1991).

§ 25-2-708. Seller's damages for nonacceptance or repudiation.

Legal Periodicals. — For article, "The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory," see 23 Wake Forest L. Rev. 429 (1988).

CASE NOTES

Applied in Martin v. Sheffer, 102 N.C. App. 802, 403 S.E.2d 555 (1991).

Cited in First Value Homes, Inc. v. Morse, 86 N.C. App. 613, 359 S.E.2d 42 (1987).

§ 25-2-709. Action for the price.

CASE NOTES

Seller May Recover Contract Price and Reasonable Expenses. — A buyer who accepts goods must pay the seller the contract price, but can sue the seller for breach of warranty. Stimpson Hosiery Mills, Inc. v. Pam Trading Corp., 98 N.C. App. 543, 392 S.E.2d 128 (1990).

What Seller Must Prove. — In accord with the main volume. See Roy Burt Enters., Inc. v. Marsh, 328 N.C. 262, 400 S.E.2d 425 (1991).

§ 25-2-710. Seller's incidental damages.

Legal Periodicals. — For article, "The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory," see 23 Wake Forest L. Rev. 429 (1988).

CASE NOTES

Cited in First Value Homes, Inc. v. Morse, 86 N.C. App. 613, 359 S.E.2d 42 (1987).

§ 25-2-711. Buyer's remedies in general; buyer's security interest in rejected goods.

Cross References. — As to the New Motor Vehicles Warranties Act, see § 20-351 et seq.

Legal Periodicals. —

For article, "The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory," see 23 Wake Forest L. Rev. 429 (1988).

CASE NOTES

Failure to Provide Adequate Notification of Revocation. — Where plaintiffs never notified defendant of their revocation of acceptance of defective automobile, plaintiffs were not entitled to damages under this section. Instead, plaintiffs were only entitled to damages for breach of warranty as set forth in § 25-2-714. Riley v. Ken Wilson Ford, Inc., 109 N.C. App. 163, 426 S.E.2d 717 (1993).

Buyer's Are "Creditors" in Bankruptcy Proceeding. — Buyer's restitutionary right to payment for breach of performance contingent upon seller's failure to deliver goods, fell within the Bankruptcy Code's definition of "claim" and thereby rendered buyer a "creditor" of the seller, under the Bankruptcy Code. Sigmon v. Royal Cake Co., 13 F.3d 818 (4th Cir. 1994).

Cited in Whitehurst v. Crisp R.V. Ctr., Inc., 86 N.C. App. 521, 358 S.E.2d 542 (1987); Alberti v. Manufactured Homes, Inc., 329 N.C. 727, 407 S.E.2d 819 (1991).

§ 25-2-712. "Cover"; buyer's procurement of substitute goods.

Legal Periodicals. —

For article, "The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory," see 23 Wake Forest L. Rev. 429 (1988).

§ 25-2-713. Buyer's damages for nondelivery or repudiation.

Legal Periodicals. —

For article, "The Seller's Election of Remedies Under the Uniform Commercial Code: An Expectation Theory," see 23 Wake Forest L. Rev. 429 (1988).

§ 25-2-714. Buyer's damages for breach in regard to accepted goods.

Legal Periodicals. —

For note on North Carolina's automobile warranty legislation, see 66 N.C.L. Rev. 1080 (1988).

CASE NOTES

The general measure of damages, etc. —

In accord with the first paragraph in the main volume. See Cato Equip. Co. v. Matthews, 91 N.C. App. 546, 372 S.E.2d 872 (1988).

Plaintiffs never notified defendant of their revocation of acceptance of defective automobile; therefore, plaintiffs were not entitled to damages under § 25-2-711; instead they were entitled to damages for breach of warranty as set forth in this section. Riley v. Ken Wilson Ford, Inc., 109 N.C. App. 163, 426 S.E.2d 717 (1993).

The value differential formula set

out in subsection (2) of this section applies absent a showing of "special circumstances." Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

"Litigation by Consent". — Although the plaintiff failed to formally move to amend its complaint to allow recovery for damages involving special circumstances as under subdivision (2) of this section, under the rule of "litigation by consent," failure by defendant to object to the proffered evidence permitted the trial judge to admit and consider the additional damages. Sharrard, McGee & Co. v. Suz's Software, Inc., 100 N.C. App. 428, 396 S.E.2d 815 (1990).

Applied in Alberti v. Manufactured Homes, Inc., 329 N.C. 727, 407 S.E.2d 819 (1991).

Cited in Olivetti Corp. v. Ames Bus. Sys., 319 N.C. 534, 356 S.E.2d 578 (1987); Whitehurst v. Crisp R.V. Ctr., Inc., 86 N.C. App. 521, 358 S.E.2d 542 (1987).

§ 25-2-715. Buyer's incidental and consequential damages.

Legal Periodicals. —

For article, "Damages and Problems of Proof with Planted Nonconforming Seeds," see 9 Campbell L. Rev. 63 (1986).

CASE NOTES

Applied in Riley v. Ken Wilson Ford, Inc., 109 N.C. App. 163, 426 S.E.2d 717 (1993).

Quoted in Stimpson Hosiery Mills, Inc. v. Pam Trading Corp., 98 N.C. App. 543, 392 S.E.2d 128 (1990).

Cited in Whitehurst v. Crisp R.V. Ctr., Inc., 86 N.C. App. 521, 358 S.E.2d 542 (1987).

§ 25-2-716. Buyer's right to specific performance or replevin.

Legal Periodicals. —

For article, "Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law," see 1987 Duke L.J. 1.

§ 25-2-718. Liquidation or limitation of damages; deposits.

(1) Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

(2) Where the seller justifiably withholds delivery of goods because of the buyer's breach, the buyer is entitled to restitution of any amount by which the sum of his payments exceeds

(a) the amount to which the seller is entitled by virtue of terms liquidating the seller's damages in accordance with subsection (1),

(b) in the absence of such terms, twenty per cent (20%) of the value of the total performance for which the buyer is obligated under the contract or five hundred dollars ($500.00), whichever is smaller, or

(c) at the election of the seller in the case of a layaway contract, the aggregate payments received by seller from buyer under the contract or fifty dollars ($50.00), whichever is smaller.

(3) The buyer's right to restitution under subsection (2) is subject to offset to the extent that the seller establishes

(a) a right to recover damages under the provisions of this article other than subsection (1), and

(b) the amount or value of any benefits received by the buyer directly or indirectly by reason of the contract.

(4) Where a seller has received payment in goods their reasonable value or the proceeds of their resale shall be treated as payments for the purposes of subsection (2); but if the seller has notice of the buyer's breach before reselling goods received in part performance, his resale is subject to the conditions laid down in this article on resale by an aggrieved seller (G.S. 25-2-706). (1965, c. 700, s. 1; 1993, c. 340, s. 2.)

Effect of Amendments. — The 1993 amendment, effective October 1, 1993, in subdivision (2)(a), deleted "or " from the end; added "or" at the end of subdivision (2)(b); and added subdivision (2)(c).

CASE NOTES

A contractual clause authorizing specific performance is different in kind from a liquidated damages clause. Martin v. Sheffer, 102 N.C. App. 802, 403 S.E.2d 555 (1991).

To find unconscionability there must be an absence of meaningful choice on part of one of the parties together with contract terms which are unreasonably favorable to the other. Martin v. Sheffer, 102 N.C. App. 802, 403 S.E.2d 555 (1991).

Expansion of Seller's Remedies Not Unconscionable. — Parties were free to shape their remedies according to their particular needs, and an expansion of the seller's remedies beyond those specified in the Uniform Commercial Code to include specific performance was neither unreasonable nor unconscionable. Martin v. Sheffer, 102 N.C. App. 802, 403 S.E.2d 555 (1991).

Cited in First Value Homes, Inc. v. Morse, 86 N.C. App. 613, 359 S.E.2d 42 (1987).

§ 25-2-719. Contractual modification or limitation of remedy.

Legal Periodicals. —

For article, "Damages and Problems of Proof with Planted Nonconforming Seeds," see 9 Campbell L. Rev. 63 (1986).

CASE NOTES

Expansion of Remedy Beyond Commercial Code Not Unconscionable. — Parties were free to shape their remedies according to their particular needs, and an expansion of the seller's remedies beyond those specified in the Uniform Commercial Code to include specific performance was neither unreasonable nor unconscionable. Martin v. Sheffer, 102 N.C. App. 802, 403 S.E.2d 555 (1991).

Under this section, a remedy stated in the contract is optional unless the remedy is expressly agreed to be exclusive. Foley v. L & L Int'l, Inc., 88 N.C. App. 710, 364 S.E.2d 733 (1988).

§ 25-2-721. Remedies for fraud.

CASE NOTES

Cited in Olivetti Corp. v. Ames Bus. Sys., 319 N.C. 534, 356 S.E.2d 578 (1987).

§ 25-2-725. Statute of limitations in contracts for sale.

Cross References. — As to three year statute of limitations for actions upon contracts generally, see § 1-52. As to two year statute of limitations for actions against a local unit of government upon a contract, see § 1-53.

CASE NOTES

Plea of Statute of Limitation as Notice of Lack of Justiciable Issue. — When defendant's answer raising the statute of limitations defense was filed and served, it should have become apparent to plaintiff that, barring circumstances permitting the statute of limitations to be tolled, the complaint no longer contained a justiciable issue. Sunamerica Fin. Corp. v. Bonham, 328 N.C. 254, 400 S.E.2d 435 (1991).

Arbitration Is Neither an "Action" Nor a "Judicial Proceeding". — By its terms, the limitations period stated in this section applies only to an "action," which, under § 25-1-201(1) is a "judicial proceeding," and an arbitration is neither an "action" nor a "judicial proceeding," but a nonjudicial, out-of-court proceeding which makes an action or judicial proceeding unnecessary. In re Cameron, 91 N.C. App. 164, 370 S.E.2d 704 (1988).

Action Barred. — Where the manufacturer's express warranty of a mobile home purchased by plaintiffs covered a period of approximately one year, where defendant tendered delivery of the mobile home in April 1986, and where plaintiffs noticed water damage over four years later in September 1990 but did not file their complaint until 9 April 1991, plaintiff had no right to recovery under the manufacturer's express warranty due to its expiration, and having filed their complaint on 9 April 1991, plaintiffs also failed to commence their action within four years after defendant tendered delivery. Reece v. Homette Corp., 110 N.C. App. 462, 429 S.E.2d 768 (1993).

Applied in Riley v. Ken Wilson Ford, Inc., 109 N.C. App. 163, 426 S.E.2d 717 (1993).

Cited in Cellu Prods. Co. v. G.T.E. Prods. Corp., 81 N.C. App. 474, 344 S.E.2d 566 (1986); American Multimedia, Inc. v. Freedom Distrib., Inc., 95 N.C. App. 750, 384 S.E.2d 32 (1989).

Article 2A.

Leases.

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PART 1.

GENERAL PROVISIONS.

§ 25-2A-101. Short title.

This Article shall be known and may be cited as the Uniform Commercial Code — Leases. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Rationale for Codification: There are several reasons for codifying the law with respect to leases of goods. An analysis of the case law as it applies to leases of goods suggests at least three significant issues to be resolved by codification. First, what is a lease? It is necessary to define lease to determine whether a transaction creates a lease or a security interest disguised as a lease. If the transaction creates a security interest disguised as a lease, the lessor will be required to file a financing statement or take other action to perfect its interest in the goods against third parties. There is no such requirement with respect to leases. Yet the distinction between a lease and a security interest disguised as a lease is not clear. Second, will the lessor be deemed to have made warranties to the lessee? If the transaction is a sale the express and implied warranties of Article 2 of the Uniform Commercial Code apply. However, the warranty law with respect to leases is uncertain. Third, what remedies are available to the lessor upon the lessee's default? If the transaction is a security interest disguised as a lease, the answer is stated in Part 5 of the Article on Secured Transactions (Article 9). There is no clear answer with respect to leases.

There are reasons to codify the law with respect to leases of goods in addition to those suggested by a review of the reported cases. The answer to this important question should not be limited to the issues raised in these cases. It is not also proper to determine the remedies available to the lessee upon the lessor's default? It is, but that issue is not reached through a review of the reported cases. This is only one of the many issues presented in structuring, negotiating and documenting a lease of goods.

Statutory Analogue: After it was decided to proceed with the codification project, the drafting committee of the National Conference of Commissioners on Uniform State Laws looked for a statutory analogue, gradually narrowing the focus to the Article on Sales (Article 2) and the Article on Secured Transactions (Article 9). A review of the literature with respect to the sale of goods reveals that Article 2 is predicated upon certain assumptions: Parties to the sales transactions frequently are without counsel; the agreement of the parties often is oral or evidenced by scant writings; obligations between the parties are bilateral; applicable law is influenced by the need to preserve freedom of contract. A review of the literature with respect to personal property security law reveals that Article 9 is predicated upon very different assumptions: Parties to a secured transaction regularly are represented by counsel; the agreement of the parties frequently is reduced to a writing, extensive in scope; the obligations between the parties are essentially unilateral; and applicable law seriously limits freedom of contract.

The lease is closer in spirit and form to the sale of goods than to the creation of a security interest. While parties to a lease are sometimes represented by counsel and their agreement is often reduced to a writing, the obligations of the parties are bilateral and the common law of leasing is dominated by the need to preserve freedom of contract. Thus the drafting committee concluded that Article 2 was the appropriate statutory analogue.

Issues: The drafting committee then identified and resolved several issues critical to codification:

Scope: The scope of the Article was limited to leases (Section 2A-102). There was no need to include leases intended as security, i.e., security interests disguised as leases, as they are adequately treated in Article 9. Further, even if leases intended as security were included, the need to preserve the distinction would remain, as policy suggests treatment significantly different from the accorded leases.

Definition of Lease: Lease was defined to exclude leases intended as security (Section 2A-103(1)(j)). Given the litigation to date a revised definition of security interest was suggested for inclusion in the Act. (Section 1-201(37)). This revision sharpens the distinction between leases and security interests disguised as leases.

Filing: The lessor was not required to file a financing statement against the lessee or take any other action to protect the lessor's interest in the goods (Section 2A-301). The refined definition of security interest will more clearly signal the need to file to potential lessors of goods. Those lessors who are concerned will file a protective financing statement (Section 9-408).

Warranties: All of the express and implied warranties of the Article on Sales (Article 2) were included (Sections 2A-210 through 2A-216), revised to reflect differences in lease transactions. The lease of goods is sufficiently similar to the sale of goods to justify this decision. Further, many courts have reached the same decision.

Certificate of Title Laws: Many leasing transactions involve goods subject to certificate of title statutes. To avoid conflict with those statutes, this Article is subject to them (Section 2A-104(1)(a)).

Consumer Leases: Many leasing transactions involve parties subject to consumer protection statutes or decisions. To avoid conflict with those laws this Article is subject to them to the extent provided in (Section 2A-104(1)(c) and (2)). Further, certain consumer protections have been incorporated in the Article.

Finance Leases: Certain leasing transactions substitute the supplier of the goods for the lessor as the party responsible to the lessee with respect to warranties and the like. The definition of finance (Section 2A-103(1)(g)) was developed to describe these transactions. Various sections of the Article implement the substitution of the supplier for the lessor, including Sections 2A-209 and 2A-407. No attempt was made to fashion a special rule where the finance lessor is an affiliate of the supplier of goods; this is to be developed by the courts, case by case.

Sale and Leaseback: Sale and leaseback transactions are becoming increasingly common. A number of state statutes treat transactions where possession is retained by the seller as fraudulent *per se* or *prima facie* fraudulent. That position is not in accord with modern practice and thus is changed by the Article "if the buyer bought for value and in good faith" (Section 2A-308(3)).

Remedies: The Article has not only provided for lessor's remedies upon default by the lessee (Sections 2A-523 through 2A-531), but also for lessee's remedies upon default by the lessor (Sections 2A-508 through 2A-522). This is a significant department for Article 9, which provides remedies only for the secured party upon default by the debtor. This difference is compelled by the bilateral nature of the obligations between the parties to a lease.

Damages: Many leasing transactions are predicated on the parties' ability to stipulate an appropriate measure of damages in the event of default. The rule with respect to sale of goods (Section 2-718) is not sufficiently flexible to accommodate this practice. Consistent with the common law emphasis upon freedom to contract, the Article has created a revised rule that allows greater flexibility with respect to leases of goods (Section 2A-504(1)).

History: This Article is a revision of the Uniform Personal Property Leasing Act, which was approved by the National Conference of Commissioners on Uniform State Laws in August, 1985. However, it was believed that the subject matter of the Uniform Personal Property Leasing Act would be better treated as an article of this Act. Thus, although the Conference promulgated the Uniform Personal Property Leasing Act as a Uniform Law, activity was held in abeyance to allow time to restate the Uniform Personal Property Leasing Act as Article 2A.

In August, 1986 the Conference approved and recommended this Article (including conforming amendments to Article 1 and Article 9 for promulgation as an amendment to this Act. In December, 1986 the Council of the American Law Institute approved and recommended this Article (including conforming amendments to Article 1 and Article

9), with official comments, for promulgation as an amendment to this Act. In March, 1987 the Permanent Editorial Board for the Uniform Commercial Code approved and recommended this Article (including conforming amendments to Article 1 and Article 9), with official comments, for promulgation as an amendment to this Act. In May, 1987 the American Law Institute approved and recommended this Article (including conforming amendments to Article 1 and Article 9), with official comments, for promulgation as an amendment to this Act. In August, 1987 the Conference confirmed its approval of the final text of this Article.

Upon its initial promulgation, Article 2A was rapidly enacted in several states, was introduced in a number of other states, and underwent bar association, law revision commission and legislative study in still further states. In that process debate emerged, principally sparked by the study of Article 2A by the California Bar Association, California's non-uniform amendments to Article 2A, and articles appearing in a symposium on Article 2A published after its promulgation in the Alabama Law Review. The debate chiefly centered on whether Article 2A had struck the proper balance or was clear enough concerning the ability of a lessor to grant a security interest in its leasehold interest and in the residual, priority between a secured party and the lessee, and the lessor's remedy structure under Article 2A.

This debate over issues on which reasonable minds could and did differ began to affect the enactment effort for Article 2A in a deleterious manner. Consequently, the Standby Committee for Article 2A, composed predominantly of the former members of the drafting committee, reviewed the legislative actions and studies in the various states, and opened a dialogue with the principal proponents of the non-uniform amendments. Negotiations were conducted in conjunction with, and were facilitated by, a study of the uniform Article and the non-uniform Amendments by the New York Law Revision Commission. Ultimately, a consensus was reached, which has been approved by the membership of the Conference, the Permanent Editorial Board, and the Council of the Institute. Rapid and uniform enactment of Article 2A is expected as a result of the completed amendments. The Article 2A experience reaffirms the essential viability of the procedures of the Conference and the Institute for creating and updating uniform state law in the commercial law area.

Relationship of Article 2A to Other Articles: The Article on Sales provided as a useful point of reference for codifying the law of leases. Many of the provisions of that Article were carried over, changed to reflect differences in style, leasing terminology or lease practices. Thus, the official comments to those sections of Article 2 whose provisions were carried over are incorporated by reference in Article 2A, as well; further, any case law interpreting those provisions shall be viewed as persuasive but not binding on a court when deciding a similar issue with respect to leases. Any change in the sequence that has been made when carrying over a provision from Article 2 should be viewed as a matter of style, not substance. This is not to suggest that in other instances Article 2A did not also incorporate substantially revised provisions of Article 2, Article 9 or otherwise where the revision was driven by a concern over the substance; but for the lack of a mandate, the drafting committee might well have made the same or a similar change in the statutory analogue. Those sections in Article 2A include Sections 2A-104, 2A-105, 2A-106, 2A-108(2) and (4), 2A-109(2), 2A-208, 2A-214(2) and (3)(a), 2A-216, 2A-303, 2A-306, 2A-503, 2A-504(3)(b), 2A-506(2), and 2A-515. For lack of relevance or significance not all of the provisions of Article 2 were incorporated in Article 2A.

This codification was greatly influenced by the fundamental tenet of the common law as it had developed with respect to leases of goods: freedom of the parties to contract. Note that, like all other Articles of this Act, the principles of construction and interpretation contained in Article 1 are applicable throughout Article 2A (Section 2A-103(4)). These principles include the ability of the parties to vary the effect of the provisions of Article 2A, subject to certain limitations including those that relate to the obligations of good faith, diligence, reasonableness and care (Section 1-102(3)). Consistent with those principles no negative inference is to be drawn by the episodic use of the phrase "unless otherwise agreed" in certain provisions of Article 2A. Section 1-102(4). Indeed, the contrary is true, as the general rule in the Act, including this Article, is that the effect of the Act's provisions may be varied by agreement. Section 1-102(3). This conclusion follows even where the statutory analogue contains the phrase and the correlative provision in Article 2A does not.

Editor's Note. — Session Laws 1993, c. 463, s. 6 made this Article effective October 1, 1993, but not applicable to pending litigation.

Session Laws 1993, c. 463, s. 4 provides: "The revisor of statutes shall cause to be printed along with this act all relevant portions of the official comments to the Uniform Commercial Code, Article 2A, as the revisor deems appropriate."

§ 25-2A-102. Scope.

This Article applies to any transaction, regardless of form, that creates a lease. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-102(1). Throughout this Article, unless otherwise stated, references to "Section" are to other sections of this Act.

Changes: Substantially revised.

Purposes:

This Article governs transactions as diverse as the lease of a hand tool to an individual for a few hours and the leveraged lease of a complex line of industrial equipment to a multi-national organization for a number of years.

To achieve that end it was necessary to provide that this Article applies to any transaction, regardless of form, that creates a lease. Since lease is defined as a transfer of an interest in goods (Section 2A-103(1)(j)) and goods is defined to include fixtures (Section 2A-103(1)(h)), application is limited to the extent the transaction relates to goods, including fixtures. Further, since the definition of lease does not include a sale (Section 2-106(1)) or retention or creation of a security interest (Section 1-201(37)), application is further limited; sales and security interests are governed by other Articles of this Act.

Finally, in recognition of the diversity of the transactions to be governed, the sophistication of many of the parties to these transactions, and the common law tradition as it applies to the bailment for hire or lease, freedom of contract has been preserved. DeKoven, Proceedings After Default by the Lessee Under a True Lease of Equipment, in 1C P. Coogan, W. Hogan, D. Vagts, *Secured Transactions Under the Uniform Commercial Code,* § 29B.02[2] (1986). Thus, despite the extensive regulatory scheme established by this Article, the parties to a lease will be able to create private rules to govern their transaction. Sections 2A-103(4) and 1-102(3). However, there are special rules in this Article governing consumer leases, as well as other state and federal statutes, that may further limit freedom of contract with respect to consumer leases.

A court may apply this Article by analogy to any transaction, regardless of form, that creates a lease of personal property other than goods, taking into account the expressed intentions of the parties to the transaction and any differences between a lease of goods and a lease of other property. Such application has precedent as the provisions of the Article on Sales (Article 2) have been applied by analogy to leases of goods. *E.g.,* Hawkland, *The Impact of the Uniform Commercial Code on Equipment Leasing,* 1972 Ill. L.F. 446; Murray, *Under the Spreading Analogy of Article 2 of the Uniform Commercial Code,* 39 Fordham L. Rev. 447 (1971). Whether such application would be appropriate for other bailments of personal property, gratuitous or for hire, should be determined by the facts of each case. *See Mieske v. Bartell Drug Co.,* 92 Wash.2d 40, 46-48, 593 P.2d 1308, 1312 (1979).

Further, parties to a transaction creating a lease of personal property other than goods, or a bailment of personal property may provide by agreement that this Article applies. Upholding the parties' choice is consistent with the spirit of this Article.

Cross References:

Sections 1-102(3), 1-201(37), Article 2, esp. Section 2-106(1), and Sections 2A-103(1)(h), 2A-103(1)(j) and 2A-103(4).

Definitional Cross References:

"Lease". Section 2A-103(1)(j).

§ 25-2A-103. Definitions and index of definitions.

(1) In this Article unless the context otherwise requires:

(a) "Buyer in ordinary course of business", means a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest or leasehold interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. "Buying" may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a preexisting contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

(b) "Cancellation" occurs when either party puts an end to the lease contract for default by the other party.

(c) "Commercial unit" means such a unit of goods as by commercial usage is a single whole for purposes of lease and division of which materially impairs its character or value on the market or in use. A commercial unit may be a single article, as a machine, or a set of articles, as a suite of furniture or a line of machinery, or a quantity, as a gross or carload, or any other unit treated in use or in the relevant market as a single whole.

(d) "Conforming" goods or performance under a lease contract means goods or performance that are in accordance with the obligations under the lease contract.

(e) "Consumer lease" means a lease that a lessor regularly engaged in the business of leasing or selling makes to a lessee who is an individual and who takes under the lease primarily for a personal, family, or household purpose, if the total payments to be made under the lease contract, excluding payments for options to renew or buy, do not exceed twenty-five thousand dollars ($25,000).

(f) "Fault" means wrongful act, omission, breach, or default.

(g) "Finance lease" means a lease with respect to which: (i) the lessor does not select, manufacturer, or supply the goods; (ii) the lessor acquires the goods or the right to possession and use of the goods in connection with the lease; and (iii) one of the following occurs:

(A) the lessee receives a copy of the contract by which the lessor acquired the goods or the right to possession and use of the goods before signing the lease contract;

(B) the lessee's approval of the contract by which the lessor acquired the goods or the right to possession and use of the goods is a condition to effectiveness of the lease contract;

(C) the lessee, before signing the lease contract, receives an accurate and complete statement designating the promises and warranties, and any disclaimers of warranties, limitations or modifications of remedies, or liquidated damages, including those of a third party, such as the manufacturer of the goods, provided to the lessor by the person supplying the goods in connection with or as part of the contract by which the lessor acquired the goods or the right to possession and use of the goods; or

(D) if the lease is not a consumer lease, the lessor, before the lessee signs the lease contract, informs the lessee in writing (a) of the identity of the person supplying the goods to the lessor, unless the lessee has selected that person and directed the lessor to acquire the goods or the right to possession and use of the goods from that person, (b) that the lessee is entitled under this Article to the promises and warranties, including those of any third party, provided to the lessor by the person supplying the goods in connection with or as part of the contract by which the lessor acquired the goods or the right to possession and use of the goods, and (c) that the lessee may communicate with the person supplying the goods to the lessor and receive an accurate and complete statement of those promises and warranties, including any disclaimers and limitations of them or of remedies.

(h) "Goods" means all things that are movable at the time of identification to the lease contract, or are fixtures (G.S. 25-2A-309), but the term does not include money, documents, instruments, accounts, chattel paper, general intangibles, or minerals or the like, including oil and gas, before extraction. The term also includes the unborn young of animals.

(i) "Installment lease contract" means a lease contract that authorizes or requires the delivery of goods in separate lots to be separately accepted, even though the lease contract contains a clause "each delivery is a separate lease" or its equivalent.

(j) "Lease" means a transfer of the right to possession and use of goods for a term in return for consideration, but a sale, including a sale on approval or a sale or return, or retention or creation of a security interest is not a lease. Unless the context clearly indicates otherwise, the term includes a sublease. The term includes a motor vehicle operating agreement that is considered a lease under § 7701(h) of the Internal Revenue Code.

(k) "Lease agreement" means the bargain, with respect to the lease, of the lessor and the lessee in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in this Article. Unless the context clearly indicates otherwise, the term includes a sublease agreement.

(*l*) "Lease contract" means the total legal obligation that results from the lease agreement as affected by this Article and any other applicable rules of law. Unless the context clearly indicates otherwise, the term includes a sublease contract.

(m) "Leasehold interest" means the interest of the lessor or the lessee under a lease contract.

(n) "Lessee" means a person who acquires the right to possession and use of goods under a lease. Unless the context clearly indicates otherwise, the term includes a sublessee.

(o) "Lessee in ordinary course of business" means a person who in good faith and without knowledge that the lease to him is in violation of the ownership rights or security interest or leasehold interest of a third party in the goods leases in ordinary course from a person in the business of selling or leasing goods of that kind but does not include a pawnbroker. "Leasing" may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a preexisting lease contract but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

(p) "Lessor" means a person who transfers the right to possession and use of goods under a lease. Unless the context clearly indicates otherwise, the term includes a sublessor.

(q) "Lessor's residual interest" means the lessor's interest in the goods after expiration, termination, or cancellation of the lease contract.

(r) "Lien" means a charge against or interest in goods to secure payment of a debt or performance of an obligation, but the term does not include a security interest.

(s) "Lot" means a parcel or a single article that is the subject matter of a separate lease or delivery, whether or not it is sufficient to perform the lease contract.

(t) "Merchant lessee" means a lessee that is a merchant with respect to goods of the kind subject to the lease.

(u) "Present value" means the amount as of a date certain of one or more sums payable in the future, discounted to the date certain. The discount is determined by the interest rate specified by the parties if the rate was not manifestly unreasonable at the time the transaction was entered into; otherwise, the discount is determined by a commercially reasonable rate that takes into account the facts and circumstances of each case at the time the transaction was entered into.

(v) "Purchase" includes taking by sale, lease, mortgage, security interest, pledge, gift, or any other voluntary transaction creating an interest in goods.

(w) "Sublease" means a lease of goods the right to possession and use of which was acquired by the lessor as a lessee under an existing lease.

(x) "Supplier" means a person from whom a lessor buys or leases goods to be leased under a finance lease.

(y) "Supply contract" means a contract under which a lessor buys or leases goods to be leased.

(z) "Termination" occurs when either party pursuant to a power created by agreement or law puts an end to the lease contract otherwise than for default.

(2) Other definitions applying to this Article and the sections in which they appear are:

"Accessions". G.S. 25-2A-310(1).

"Construction mortgage". G.S. 25-2A-309(1)(d).
"Encumbrance". G.S. 25-2A-309(1)(e).
"Fixtures". G.S. 25-2A-309(1)(a).
"Fixture filing". G.S. 25-2A-309(1)(b).
"Purchase money lease". G.S. 25-2A-309(1)(c).

(3) The following definitions in other Articles apply to this Article:

"Account". G.S. 25-9-106.
"Between merchants". G.S. 25-2-104(3).
"Buyer". G.S. 25-2-103(1)(a).
"Chattel paper". G.S. 25-9-105(1)(b).
"Consumer goods". G.S. 25-9-109(1).
"Document". G.S. 25-9-105(1)(f).
"Entrusting". G.S. 25-2-403(3).
"General intangibles". G.S. 25-9-106.
"Good faith". G.S. 25-2-103(1)(b).
"Instrument". G.S. 25-9-105(1)(i).
"Merchant". G.S. 25-2-104(1).
"Mortgage". G.S. 25-9-105(1)(j).
"Pursuant to commitment". G.S. 25-9-105(1)(k).
"Receipt". G.S. 25-2-103(1)(c).
"Sale". G.S. 25-2-106(1).
"Sale on approval". G.S. 25-2-326.
"Sale or return". G.S. 25-2-326.
"Seller". G.S. 25-2-103(1)(d).

(4) In addition, Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article. (1993, c. 463, s. 1; 1993 (Reg. Sess., 1994), c. 756, s. 1.)

OFFICIAL COMMENT

(a) "Buyer in ordinary course of business". Section 1-201(9).

(b) "Cancellation". Section 2-106(4). The effect of a cancellation is provided in Section 2A-505(1).

(c) "Commercial unit". Section 2-105(6).

(d) "Conforming". Section 2-106(2).

(e) "Consumer lease". New. This Article includes a subset of rules that applies only to consumer leases. Sections 2A-106, 2A-108(2), 2A-108(4), 2A-109(2), 2A-221, 2A-309, 2A-406, 2A-407, 2A-504(3)(b), and 2A-516(3)(b).

For a transaction to qualify as a consumer lease it must first qualify as a lease. Section 2A-103(1)(j). Note that this Article regulates the transactional elements of a lease, including a consumer lease; consumer protection statutes, present and future, and existing consumer protection decisions are unaffected by this Article. Section 2A-104(1)(c) and (2). Of course, Article 2A as state law also is subject to federal consumer protection law.

This definition is modeled after the definition of consumer lease in the Consumer Leasing Act, 15 U.S.C. § 1667 (1982), and in the Unif. Consumer Credit Code § 1.301(14), 7A U.L.A. 43 (1974). However, this definition of consumer lease differs from its models in several respects: the lessor can be a person regularly engaged either in the business of leasing or of selling goods, the lease need not be for a term exceeding four months, a lease primarily for an agricultural purpose is not covered, and whether there should be a limitation by dollar amount and its amount is left up to the individual states.

This definition focuses on the parties as well as the transaction. If a lease is within this definition, the lessor must be regularly engaged in the business of leasing or selling, and the lessee must be an individual not an organization; note that a lease to two or more individuals having a common interest through marriage or the like is not excluded as a lease to an organization under Section 1-201(28). The lessee must take the interest primarily for a personal, family or household purpose. If required by the enacting state, total payments under the lease contract, excluding payments for options to renew or buy, cannot exceed the figure designated.

(f) "Fault". Section 1-201(16).

(g) "Finance Lease". New. This Article includes a subset of rules that applies only to finance leases. Sections 2A-209, 2A-211(2), 2A-212(1), 2A-213, 2A-219(1), 2A-220(1)(a), 2A-221, 2A-405(c), 2A-407, 2A-516(2) and 2A-517(1)(a) and (2).

For a transaction to qualify as a finance lease it must first qualify as a lease. Section 2A-103(1)(j). Unless the lessor is comfortable that the transaction will qualify as a finance lease, the lease agreement should include provisions giving the lessor the benefits created by the subset of rules applicable to the transaction that qualifies as a finance lease under this Article.

A finance lease is the product of a three-party transaction. The supplier manufactures or supplies the goods pursuant to the lessee's specification, perhaps even pursuant to a purchase order, sales agreement or lease agreement between the supplier and the lessee. After the prospective finance lease is negotiated, a purchase order, sales agreement, or lease agreement is entered into by the lessor (as buyer or prime lessee) or an existing order, agreement or lease is assigned by the lessee to the lessor, and the lessor and the lessee then enter into a lease or sublease of the goods. Due to the limited function usually performed by the lessor, the lessee looks almost entirely to the supplier for representations, covenants and warranties. If a manufacturer's warranty carries through, the lessee may also look to that. Yet, this definition does not restrict the lessor's function solely to the supply of funds; if the lessor undertakes or performs other functions, express warranties, covenants and the common law will protect the lessee.

This definition focuses on the transaction, not the status of the parties; to avoid confusion it is important to note that in other contexts, e.g., tax and accounting, the term finance lease has been used to connote different types of lease transactions, including leases that are disguised secured transactions. M. Rice, Equipment Financing, 62-71 (1981). A lessor who is a merchant with respect to goods of the kind subject to the lease may be a lessor under a finance lease. Many leases that are leases back to the seller of goods (Section 2A-308(3)) will be finance leases. This conclusion is easily demonstrated by a hypothetical. Assume that B had bought goods from C pursuant to a sales contract. After delivery to and acceptance of the goods by B, B negotiates to sell the goods to A and simultaneously to lease the goods back from A, on terms and conditions that, we assume, will qualify the transaction as a lease. Section 2A-103(1)(j). In documenting the sale and lease back, B assigns the original sales contract between B, as buyer, and C, as seller, to A. A review of these facts leads to the conclusion that the lease from A to B qualifies as a finance lease, as all three conditions of the definition are satisfied. Subparagraph (i) is satisfied as A, the lessor, had nothing to do with the selection, manufacture, or supply of the equipment. Subparagraph (ii) is satisfied as A, the lessor, bought the equipment at the same time that A leased the equipment to B, which certainly is in connection with the lease. Finally, subparagraph (iii) (A) is satisfied as A entered into the sales contract with B at the same time that A leased the equipment back to B. B, the lessee, will have received a copy of the sales contract in a timely fashion.

Subsection (i) requires the lessor to remain outside the selection, manufacture and supply of the goods; that is the rationale for releasing the lessor from most of its traditional liability. The lessor is not prohibited from possession, maintenance or operation of the goods, as policy does not require such prohibition. To insure the lessee's reliance on the supplier, and not on the lessor, subsection (ii) requires that the goods (where the lessor is the buyer of the goods) or that the right to possession and use of the goods (where the lessor is the prime lessee and the sublessor of the goods) be acquired in connection with the lease (or sublease) to qualify as a finance lease. The scope of the phrase "in connection with" is to be developed by the courts, case by case. Finally, as the lessee generally relies almost entirely upon the supplier for representations and covenants, and upon the supplier or a manufacturer, or both, for warranties with respect to the goods, subsection (iii) requires that one of the following occur: (A) the lessee receive a copy of the supply contract before signing the lease contract; (B) the lessee's approval of the supply contract is a condition to the effectiveness of the lease contract; (C) the lessee receive a statement describing the promises and warranties and any limitations relevant to the lessee before signing the lease contract; or (D) before signing the lease contract and except in a consumer lease, the lessee receive a writing identifying the supplier (unless the supplier was selected and required by the lessee) and the rights of the lessee under Section 2A-209, and advising the lessee a statement of promises and warranties is available from the supplier. Thus, even where oral supply orders or computer placed supply orders are compelled by custom and usage the transaction may still qualify as a finance lease if the lessee approves the supply contract before the lease contract is effective and such approval was a condition to the effectiveness of the lease contract. Moreover, where the lessor does not want the lessee to see the entire supply contract, including price information, the lessee may be provided with a separate statement of the terms of the supply contract relevant to the lessee; promises between the supplier and the lessor that do not affect the lessee need not be included. The statement can be a restatement of those terms or a copy of portions of the supply contract with the relevant terms clearly designated. Any implied warranties need not be designated, but a disclaimer or modification of remedy must be designated. A copy of any manufacturer's warranty is sufficient if that is the warranty provided. However, a copy of any Regulation M disclosure given pursuant to 12 C.F.R. § 213.4(g) concerning warranties in itself is not sufficient since those disclosures need only briefly identify express warranties and need not include any disclaimer of warranty.

If a transaction does not qualify as a finance lease, the parties may achieve the same result by agreement; no negative implications are to be drawn if the transaction does not qualify. Further, absent the application of special rules (fraud, duress, and the like), a lease that qualifies as a finance lease and is assigned by the lessor or the lessee to a third party does not lose its status as a finance lease under this Article. Finally, this Article creates no special rule where the lessor is an affiliate of the supplier; whether the transaction qualifies as a finance lease will be determined by the facts of each case.

(h) "Goods". Section 9-105(1)(h). See Section 2A-103(3) for reference to the definition of "Account", "Chattel paper", "Document", "General intangibles" and "Instrument". See Section 2A-217 for determination of the time and manner of identification.

(i) "Installment lease contract". Section 2-612(1).

(j) "Lease". New. There are several reasons to codify the law with respect to leases of goods. An analysis of the case law as it applies to leases of goods suggests at least several significant issues to be resolved by codification. First and foremost is the definition of a lease. It is necessary to define lease to determine whether a transaction creates a lease or a security interest disguised as a lease. If the transaction creates a security interest disguised as a lease, the transaction will be governed by the Article on Secured Transactions (Article 9) and the lessor will be required to file a financing statement or take other action to perfect its interest in the goods against third parties. There is no such requirement with respect to leases under the common law and, except with respect to leases of fixtures (Section 2A-309), this Article imposes no such requirement. Yet the distinction between a lease and a security interest disguised as a lease is not clear from the case law at the time of the promulgation of this Article. DeKoven, *Leases of Equipment: Puritan Leasing Company v. August, A Dangerous Decision*, 12 U.S.F. L.Rev. 257 (1978).

At common law a lease of personal property is a bailment for hire. While there are several definitions of bailment for hire, all require a thing to be let and a price for the letting. Thus, in modern terms and as provided in this definition, a lease is created when the lessee agrees to furnish consideration for the right to the possession and use of goods over a specified period of time. Mooney, *Personal Property Leasing: A Challenge*, 36 Bus.Law. 1605, 1607 (1981). Further, a lease is neither a sale (Section 2-106(1)) nor a retention or creation of a security interest (Section 1-201(37)). Due to extensive litigation to distinguish true leases from security interests, an amendment to Section 1-201(37) has been promulgated with this Article to create a sharper distinction.

This section as well as Section 1-201(37) must be examined to determine whether the transaction in question creates a lease or a security interest. The following hypotheticals indicate the perimeters of the issue. Assume that

A has purchased a number of copying machines, new, for $1,000 each; the machines have an estimated useful economic life of three years. A advertises that the machines are available to rent for a minimum of one month and that the monthly rental is $100.00. A intends to enter into leases where A provides all maintenance, without charge to the lessee. Further, the lessee will rent the machine, month to month, with no obligation to renew. At the end of the lease term the lessee will be obligated to return the machine to A's place of business. This transaction qualifies as a lease under the first half of the definition, for the transaction includes a transfer by A to a prospective lessee of possession and use of the machine for a stated term, month to month. The machines are goods (Section 2A-103(1)(h)). The lessee is obligated to pay consideration in return, $100.00 for each month of the term.

However, the second half of the definition provides that a sale or a security interest is not a lease. Since there is no passing of title, there is no sale. Sections 2A-103(3) and 2-106(1). Under pre-Act security law this transaction would have created a bailment for hire or a true lease and not a conditional sale. *Da Rocha v. Macomber*, 330 Mass. 611, 614-15, 116 N.E.2d 139, 142 (1953). Under Section 1-201(37), as amended with the promulgation of this Article, the same result would follow. While the lessee is obligated to pay rent for the one-month term of the lease, one of the other four conditions of the second paragraph of Section 1-201(37) must be met and none is. The term of the lease is one month and the economic life of the machine is 36 months; thus, subparagraph (a) of Section 1-201(37) is not now satisfied. Considering the amount of the monthly rent, absent economic duress or coercion, the lessee is not bound either to renew the lease for the remaining economic life of the goods or to become the owner. If the lessee did lease the machine for 36 months, the lessee would have paid the lessor $3,600 for a machine that could have been purchased for $1,000; thus, subparagraph (b) of Section 1-201(37) is not satisfied. Finally, there are no options; thus, subparagraphs (c) and (d) of Section 1-201(37) are not satisfied. This transaction creates a lease, not a security interest. However, with each renewal of the lease the facts and circumstances at the time of each renewal must be examined to determine if that conclusion remains accurate, as it is possible that a transaction that first creates a lease, later creates a security interest.

Assume that the facts are changed and that A requires each lessee to lease the goods for 36 months, with no right to terminate. Under pre-Act security law this transaction would have created a conditional sale, and not a bailment for hire or true lease. *Hervey v. Rhode Island Locomotive Works*, 93 U.S. 664, 672-73 (1876). Under this subsection, and Section 1-201(37), as amended with the inclusion of this Article in the Act, the same result would follow. The lessee's obligation for the term is not subject to termination by the lessee and the term is equal to the economic life of the machine.

Between these extremes there are many transactions that can be created. Some of the transactions have not been properly categorized by the courts in applying the 1978 and earlier Official Texts of Section 1-201(37). This subsection, together with Section 1-201(37), as amended with the promulgation of this Article, draws a brighter line, which should create a clearer signal to the professional lessor and lessee.

(k) "Lease agreement". This definition is derived from the first sentence of Section 1-201(3). Because the definition of lease is broad enough to cover future transfers, lease agreement includes an agreement contemplating a current or subsequent transfer. Thus it was not necessary to make an express reference to an agreement for the future lease of goods (Section 2-106(1)). This concept is also incorporated in the definition of lease contract. Note that the definition of lease does not include transactions in ordinary building materials that are incorporated into an improvement on land. Section 2A-309(2).

The provisions of this Article, if applicable, determine whether a lease agreement has legal consequences; otherwise the law of bailments and other applicable law determine the same. Sections 2A-103(4) and 1-103.

(*l*) "Lease contract". This definition is derived from the definition of contract in Section 1-201(11). Note that a lease contract may be for the future lease of goods, since this notion is included in the definition of lease.

(m) "Leasehold interest". New.

(n) "Lessee". New.

(o) "Lessee in ordinary course of business". Section 1-201(9).

(p) "Lessor". New.

(q) "Lessor's residual interest". New.

(r) "Lien". New. This term is used in Section 2A-307 (Priority of Liens Arising by Attachment or Levy on, Security Interests in, and Other Claims to Goods).

(s) "Lot". Section 2-105(5).

(t) "Merchant lessee". New. This term is used in Section 2A-511 (Merchant Lessee's Duties as to Rightfully Rejected Goods). A person may satisfy the requirement of dealing in goods of the kind subject to the lease as lessor, lessee, seller, or buyer.

(u) "Present value". New. Authorities agree that present value should be used to determine fairly the damages payable by the lessor or the lessee on default. *E.g., Taylor v. Commercial Credit Equip. Corp.*, 170 Ga.App. 322, 316 S.E.2d 788 (Ct. App. 1984). Present value is defined to mean an amount that represents the discounted value as of a date certain of one or more sums payable in the future. This is a function of the economic principle that a dollar today is more valuable to the holder than a dollar payable in two years. While there is no question as to the principle, reasonable people would differ as to the rate of discount to apply in determining the value of that future dollar today. To minimize litigation, this Article allows the parties to specify the discount or interest rate, if the rate was not manifestly unreasonable at the time the transaction was entered into. In all other cases, the interest rate will be a commercially reasonable rate that takes into account the facts and circumstances of each case, as of the time the transaction was entered into.

(v) "Purchase". Section 1-201(32). This definition omits the reference to lien contained in the definition of purchase in Article 1 (Section 1-201(32)). This should not be construed to exclude consensual liens from the definition of purchase in this Article; the exclusion was mandated by the scope of the definition of lien in Section 2A-103(1)(r). Further, the definition of purchaser in this Article adds a reference to lease; as purchase is defined in Section 1-201(32) to include any other voluntary transaction creating an interest in property, this addition is not substantive.

(w) "Sublease". New.

(x) "Supplier". New.

(y) "Supply contract". New.

(z) "Termination". Section 2-106(3). The effect of a termination is provided in Section 2A-505(2).

Editor's Note. — The first letter of each defined term in this section has been capitalized at the direction of the Revisor of Statutes.

Effect of Amendments. — The 1993 (Reg. Sess., 1994) amendment, effective July 15, 1994, in subdivision (1)(j) added the third sentence.

§ 25-2A-104. Leases subject to other law.

(1) A lease, although subject to this Article, is also subject to any applicable:

(a) certificate of title statute of this State (G.S. 20-50, G.S. 75A-32 et seq.);

(b) certificate of title statute of another jurisdiction (G.S. 25-2A-105); or

(c) consumer protection statute of this State, or final consumer protection decision of a court of this State existing on the effective date of this Article.

(2) In case of conflict between this Article, other than G.S. 2A-105, 2A-304(3), and 2A-305(3), and a statute or decision referred to in subsection (1) of this section, the statute or decision controls.

(3) Failure to comply with an applicable law has only the effect specified therein. (1993, c. 463, s. 1.)

OFFICAL COMMENT

Uniform Statutory Source: Sections 9-203(4) and 9-302(3)(b) and (c).

Changes: Substantially revised.

Purposes: — 1. This Article creates a comprehensive scheme for the regulation of transactions that create leases. Section 2A-102. Thus, the Article supersedes all prior legislation dealing with leases, except to the extent set forth in this Section.

2. Subsection (1) states the general rule that a lease, although governed by the scheme of this Article, also may be governed by certain other applicable laws. This may occur in the case of a consumer lease. Section 2A-103(1)(e). Those laws may be state statutes existing prior to enactment of Article 2A or passed afterward. In this case, it is desirable for this Article to specify which statute controls. Or the law may be a pre-existing consumer protection decision. This Article preserves such decisions. Or the law may be a statute of the United States. Such a law controls without any statement in this Article under applicable principles of preemption.

An illustration of a statute of the United States that governs consumer leases is the Consumer Leasing Act, 15 U.S.C. §§ 1667-1667(e) (1982) and its implementing regulation, Regulation M, 12 C.F.R. § 213 (1986); the statute mandates disclosures of certain lease terms, delimits the liability of a lessee in leasing personal property, and regulates the advertising of lease terms. An illustration of a state statute that governs consumer leases and which if adopted in the enacting state prevails over this Article is the Unif. Consumer Credit Code, which includes many provisions similar to those of the Consumer Leasing Act, e.g. Unif. Consumer Credit Code §§ 3.202, 3.209, 3.401, 7A U.L.A. 108-09, 115, 125 (1974), as well as provisions in addition to those of the Consumer Leasing Act, e.g., Unif. Consumer Credit Code §§ 5.109-.111, 7A U.L.A. 171-76 (1974) (the right to cure a default). Such statutes may define consumer lease so as to govern transactions within and without the definition of consumer lease under this Article.

3. Under subsection (2), subject to certain limited exclusions, in case of conflict a statute or a decision described in subsection (1) prevails over this Article. For example, a provision like Unif. Consumer Credit Code § 5.112, 7A U.L.A. 176 (1974), limiting self-help repossession, prevails over Section 2A-525(3). A consumer protection decision rendered after the effective date of this Article may supplement its provisions. For example, in relation to Article 9 a court might conclude that an acceleration clause may not be enforced against an individual debtor after late payments have been accepted unless a prior notice of default is given. To the extent the decision establishes a general principle applicable to transactions other than secured transactions, it may supplement Section 2A-502.

4. Consumer protection in lease transactions is primarily left to other law. However, several provisions of this Article do contain special rules that may not be varied by agreement in the case of a consumer lease. E.g., Sections 2A-106, 2A-108, and 2A-109(2). Were that not so, the ability of the parties to govern their relationship by agreement together with the position of the lessor in a consumer lease too often could result in a one-sided lease agreement.

5. In construing this provision the reference to statute should be deemed to include applicable regulations. A consumer protection decision is "final" on the effective date of this Article if it is not subject to appeal on that date or, if subject to appeal, is not later reversed on appeal. Of course, such a decision can be overruled by a later decision or superseded by a later statute.

Cross References: — Sections 2A-103(1)(e), 2A-106, 2A-108, 2A-109(2) and 2A-525(3).

Definitional Cross Reference: — "Lease". Section 2A-103(1)(j).

§ 25-2A-105. Territorial application of Article to goods covered by certificate of title.

Subject to the provisions of G.S. 25-2A-304(3) and G.S. 25-2A-305(3), with respect to goods covered by a certificate of title issued under a statute of this State or of another jurisdiction, compliance and the effect of compliance or noncompliance with a certificate of title statute are governed by the law (including the conflict of laws rules) of the jurisdiction issuing the certificate until the earlier of (a) surrender of the certificate, or (b) four months after the goods are removed from that jurisdiction and thereafter until a new certificate of title is issued by another jurisdiction. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-103(2)(a) and (b).

Changes: Substantially revised. The provisions of the last sentence of Section 9-103(2)(b) have not been incorporated as it is superfluous in this context. The provisions of Section 9-103(2)(d) have not been incorporated because the problems dealt with are adequately addressed by this section and Sections 2A-304(3) and 305(3).

Purposes:

The new certificate referred to in (b) must be permanent, not temporary. Generally, the lessor or creditor whose interest is indicated on the most recently issued certificate of title will prevail over interests indicated on certificates issued previously by other jurisdictions. This provision reflects a policy that it is reasonable to require holders of interests in goods covered by a certificate of title to police the goods or risk losing their interests when a new certificate of title is issued by another jurisdiction.

Cross References:

Sections 2A-304(3), 2A-305(3), 9-103(2)(b) and 9-103(2)(d).

Definitional Cross References:

"Goods". Section 2A-103(1)(h).

§ 25-2A-106. Limitation on power of parties to consumer lease to choose applicable law and judicial forum.

(1) If the law chosen by the parties to a consumer lease is that of a jurisdiction other than a jurisdiction in which the lessee resides at the time the lease agreement becomes enforceable or within 30 days thereafter or in which the goods are to be used, that choice of law is not enforceable.

(2) If the judicial forum chosen by the parties to a consumer lease is a forum that would not otherwise have jurisdiction over the lessee, that choice of forum is not enforceable. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Unif. Consumer Credit Code § 1.201(8), 7A U.L.A. 36 (1974).

Changes: Substantially revised.

Purposes:

There is a real danger that a lessor may induce a consumer lessee to agree that the applicable law will be a jurisdiction that has little effective consumer protection, or to agree that the applicable forum will be a forum that is inconvenient for the lessee in the event of litigation. As a result, this section invalidates these choice of law or forum clauses, except where the law chosen is that of the state of the consumer's residence or where the goods will be kept, or the forum chosen is one that otherwise would have jurisdiction over the lessee.

Subsection (1) limits potentially abusive choice of law clauses in consumer leases. The 30-day rule in subsection (1) was suggested by Section 9-103(1)(c). This section has no effect on choice of law clauses in leases that are not consumer leases. Such clauses would be governed by other law.

Subsection (2) prevents enforcement of potentially abusive jurisdictional consent clauses in consumer leases. By using the term judicial forum, this section does not limit selection of a nonjudicial forum, such as arbitration. This section has no effect on choice of forum clauses in leases that are not consumer leases; such clauses are, as a matter of current law, "prima facie valid". The Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 10 (1972). Such clauses would be governed by other law, including the Model Choice of Forum Act (1968).

Cross Reference:
Section 9-103(1)(c).

Definitional Cross Reference:
"Consumer lease". Section 2A-103(1)(e).
"Lease agreement". Section 2A-103(1)(k).
"Lessee". Section 2A-103(1)(n).
"Goods". Section 2A-103(1)(h).
"Party". Section 1-201(29).

Cross References. — For provision declaring as void as against public policy any provision in a contract to improve real property subjecting the parties to the laws of another state or subjecting the parties to litigation and arbitration in another state, see § 22B-2. For provision that any forum selection provision in a contract entered into in North Carolina is void as against public policy, see § 22B-3.

§ 25-2A-107. Waiver or renunciation of claim or right after default.

Any claim or right arising out of an alleged default or breach of warranty may be discharged in whole or in part without consideration by a written waiver or renunciation signed and delivered by the aggrieved party. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 1-107.

Changes: Revised to reflect leasing practices and terminology. This clause is used throughout the official comments to this Article to indicate the scope of change in the provisions of the Uniform Statutory Source included in the section; these changes range from one extreme, e.g., a significant difference in practice (a warranty as to merchantability is not implied in a finance lease (Section 2A-212)) to the other extreme, e.g., a modest difference in style or terminology (the transaction governed is a lease not a sale (Section 2A-203)).

Cross References:
Sections 2A203 and 2A-212.

Definitional Cross References:
"Aggrieved party". Section 1-201(2).
"Delivery". Section 1-201(14).
"Rights". Section 1-201(36).
"Signed". Section 1-201(39).
"Written". Section 1-201(46).

§ 25-2A-108. Unconscionability.

(1) If the court as a matter of law finds a lease contract or any clause of a lease contract to have been unconscionable at the time it was made, the court may refuse to enforce the lease contract, or it may enforce the remainder of the lease contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(2) With respect to a consumer lease, if the court as a matter of law finds that a lease contract or any clause of a lease contract has been induced by unconscionable conduct or that unconscionable conduct has occurred in the collection of a claim arising from a lease contract, the court may grant appropriate relief.

(3) Before making a finding of unconscionability under subsection (1) or (2) of this section, the court, on its own motion or that of a party, shall afford the parties a reasonable opportunity to present evidence as to the setting, purpose, and effect of the lease contract or clause thereof, or of the conduct.

(4) In an action in which the lessee claims unconscionability with respect to a consumer lease:

(a) if the court finds unconscionability under subsection (1) or (2) of this section, the court shall award reasonable attorneys' fees to the lessee.

(b) if the court does not find unconscionability and the lessee claiming unconscionability has brought or maintained an action he knew to be groundless, the court shall award reasonable attorneys' fees to the party against whom the claim is made.

(c) in determining attorneys' fees, the amount of the recovery on behalf of the claimant under subsections (1) and (2) of this section is not controlling. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-302 and Unif. Consumer Credit Code § 5.108, 7A U.L.A. 167-69 (1974).

Changes: Subsection (1) is taken almost verbatim from the provisions of Section 2-302(1). Subsection (2) is suggested by the provisions of Unif. Consumer Credit Code § 5.108(1), (2), 7A U.L.A. 167 (1974). Subsection (3), taken from the provisions of Section 2-302(2), has been expanded to cover unconscionable conduct. Unif. Consumer Credit Code § 5.108(3), 7A U.L.A. 167 (1974). The provision for the award of attorney's fees to consumers, subsection (4), covers unconscionability under subsection (1) as well as (2). Subsection (4) is modeled on the provisions of Unif. Consumer Credit Code § 5.108(6), 7A U.L.A. 169 (1974).

Purposes:

Subsections (1) and (3) of this section apply the concept of unconscionability reflected in the provisions of Section 2-302 to leases. See Dillman & Assocs. v. Capitol Leasing Co., 110 Ill.App.3d 335, 342, 442 N.E.2d 311, 316 (App.Ct. 1982). Subsection (3) omits the adjective "commercial" found in subsection 2-302(2) because subsection (3) is concerned with all leases and the relevant standard of conduct is determined by the context.

The balance of the section is modeled on the provisions of Unif. Consumer Credit Code § 5.108, 7A U.L.A. 167-69 (1974). Thus subsection (2) recognizes that a consumer lease or a clause in a consumer lease may not itself be unconscionable but that the agreement would never have been entered into if unconscionable means had not been employed to induce the consumer to agree. To make a statement to induce the consumer to lease the goods, in the expectation of invoking an integration clause in the lease to exclude the statement's admissibility in a subsequent dispute, may be unconscionable. Subsection (2) also provides a consumer remedy for unconscionable conduct, such as using or threatening to use force or violence, in the collection of a claim arising from a lease contract. These provisions are not exclusive. The remedies of this section are in addition to remedies otherwise available for the same conduct under other law, for example, an action in tort for abusive debt collection or under another statute of this State for such conduct. The reference to appropriate relief in subsection (2) is intended to foster liberal administration of this remedy. Sections 2A-103(4) and 1-106(1).

Subsection (4) authorizes an award of reasonable attorney's fees if the court finds unconscionability with respect to a consumer lease under subsections (1) or (2). Provision is also made for recovery by the party against whom the claim was made if the court does not find unconscionability and does find that the consumer knew the action to be groundless. Further, subsection (4)(b) is independent of, and thus will not override, a term in the lease agreement that provides for the payment of attorney's fees.

Cross References:
Sections 1106(1), 2-302 and 2A-103(4).

Definitional Cross Reference:
"Action". Section 1-201(1).
"Consumer lease". Section 2A-103(1)(e).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Party". Section 1-201(29).

§ 25-2A-109. Option to accelerate at will.

(1) A term providing that one party or his successor in interest may accelerate payment or performance or require collateral or additional collateral "at will" or "when he deems himself insecure" or in words of similar import must be construed to mean that he has power to do so only if he in good faith believes that the prospect of payment or performance is impaired.

(2) With respect to a consumer lease, the burden of establishing good faith under subsection (1) of this section is on the party who exercised the power; otherwise, the burden of establishing lack of good faith is on the party against whom the power has been exercised. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 1-208 and Unif. Consumer Credit Code § 5.109(2), 7A U.L.A. 171 (1974).

Purposes:

Subsection (1) reflects modest changes in style to the provisions of the first sentence of Section 1-208.

Subsection (2), however, reflects a significant change in the provisions of the second sentence of Section 1-208 by creating a new rule with respect to a consumer lease. A lease provision allowing acceleration at the will of the lessor or when the lessor deems itself insecure is of critical importance to the lessee. In a consumer lease it is a provision that is not usually agreed to by the parties but is usually mandated by the lessor. Therefore, where its invocation depends not on specific criteria but on the discretion of the lessor, its use should be regulated to prevent abuse. Subsection (1) imposes a duty of good faith upon its exercises. Subsection (2) shifts the burden of establishing good faith to the lessor in the case of a consumer lease, but not otherwise.

Cross Reference:
Section 1-208.

Definitional Cross Reference:
"Burden of establishing". Section 1-201(8).
"Consumer lease". Section 2A-103(1)(e).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Party". Section 1-201(29).
"Term". Section 1-201(42).

PART 2.

FORMATION AND CONSTRUCTION OF LEASE CONTRACT.

§ 25-2A-201. Statute of frauds.

(1) A lease contract is not enforceable by way of action or defense unless:

(a) the total payments to be made under the lease contract, excluding payments for options to renew or buy, are less than one thousand dollars ($1,000); or

(b) there is a writing, signed by the party against whom enforcement is sought or by that party's authorized agent, sufficient to indicate that a lease contract has been made between the parties and to describe the goods leased and the lease term.

(2) Any description of leased goods or of the lease term is sufficient and satisfies subsection (1)(b) of this section, whether or not it is specific, if it reasonably identifies what is described.

(3) A writing is not insufficient because it omits or incorrectly states a term agreed upon, but the lease contract is not enforceable under subsection (1)(b) of this section beyond the lease term and the quantity of goods shown in the writing.

(4) A lease contract that does not satisfy the requirements of subsection (1) of this section, but which is valid in other respects, is enforceable:

(a) if the goods are to be specially manufactured or obtained for the lessee and are not suitable for lease or sale to others in the ordinary course of the lessor's business, and the lessor, before notice of repudiation is received and under circumstances that reasonably indicate that the goods are for the lessee, has made either a substantial beginning of their manufacture or commitments for their procurement;

(b) if the party against whom enforcement is sought admits in that party's pleading, testimony, or otherwise in court that a lease contract was made, but the lease contract is not enforceable under this provision beyond the quantity of goods admitted; or

(c) with respect to goods that have been received and accepted by the lessee.

(5) The lease term under a lease contract referred to in subsection (4) of this section is:

(a) if there is a writing signed by the party against whom enforcement is sought or by that party's authorized agent specifying the lease term, the term so specified;

(b) if the party against whom enforcement is sought admits in that party's pleading, testimony, or otherwise in court a lease term, the term so admitted;

(c) if there is other evidence of the parties' intent with regard to the lease term, the term so intended; or

(d) in the absence of evidence of the parties' intent, a reasonable lease term. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-201, 9-203(1) and 9-110.

Changes: This section is modeled on Section 2-201, with changes to reflect the differences between a lease contract and a contract for the sale of goods. In particular, subsection (1)(b) adds a requirement that the writing "describe the goods leased and the lease term", borrowing that concept, with revisions, from the provisions of Section 9-203(1)(a). Subsection (2), relying on the statutory analogue in Section 9-110, sets forth the minimum criterion for satisfying that requirement.

Purposes:
The changes in this section conform the provisions of Section 2-201 to custom and usage in lease transactions. Section 2-201(2), stating a special rule between merchants, was not included in this section as the number of such transactions involving leases, as opposed to sales, was thought to be modest. Subsection (4) creates no exception for transactions where payment has been made and accepted. This represents a departure from the analogue, Section 2-201(3)(c). The rationale for the departure is grounded in the distinction between sales and leases. Unlike a buyer in a sales transaction, the lessee does not tender payment in full for goods delivered, but only payment of rent for one or more months. It was decided that, as a matter of policy, this act of payment is not a sufficient substitute for the required memorandum. Subsection (5) was needed to establish the criteria for supplying the lease term if it is omitted, as the lease contract may still be enforceable under subsection (4).

Cross References:
Sections 2-201, 9-110 and 9-203(1)(a).

Definitional Cross References:
"Action". Section 1-201(1).
"Agreed". Section 1-201(3).
"Buying". Section 2A-103(1)(a).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notice". Section 1-201(25).
"Party". Section 1-201(29).
"Sale". Section 2-106(1).
"Signed". Section 1-201(39).
"Term". Section 1-201(42).
"Writing". Section 1-201(46).

§ 25-2A-202. Final written expression: parol or extrinsic evidence.

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented:

(a) by course of dealing or usage of trade or by course of performance; and
(b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-202.

Definitional Cross References:
"Agreement". Section 1-201(3).
"Course of dealing". Section 1-205.
"Party". Section 1-201(29).
"Term". Section 1-201(42).
"Usage of trade". Section 1-205.
"Writing". Section 1-201(46).

§ 25-2A-203. Seals inoperative.

The affixing of a seal to a writing evidencing a lease contract or an offer to enter into a lease contract does not render the writing a sealed instrument and the law with respect to sealed instruments does not apply to the lease contract or offer. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-203.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:
"Lease contract". Section 2A-103(1)(*l*).
"Writing". Section 1-201(46).

§ 25-2A-204. Formation in general.

(1) A lease contract may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of a lease contract.

(2) An agreement sufficient to constitute a lease contract may be found although the moment of its making is undetermined.

(3) Although one or more terms are left open, a lease contract does not fail for indefiniteness if the parties have intended to make a lease contract and there is a reasonably certain basis for giving an appropriate remedy. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-204.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:
"Agreement". Section 1-201(3).
"Lease contract". Section 2A-103(1)(*l*).
"Party". Section 1-201(29).
"Remedy". Section 1-201(34).
"Term". Section 1-201(42).

§ 25-2A-205. Firm offers.

An offer by a merchant to lease goods to or from another person in a signed writing that by its terms gives assurance it will be held open is not revocable, for lack of consideration, during the time stated or, if no time is stated, for a reasonable time, but in no event may the period of irrevocability exceed three months. Any such term of assurance on a form supplied by the offeree must be separately signed by the offeror. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-205.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Merchant". Section 2-104(1).
"Person". Section 1-201(30).
"Reasonable time". Section 1-204(1) and (2).
"Signed". Section 1-201(39).
"Term". Section 1-201(42).
"Writing". Section 1-201(46).

§ 25-2A-206. Offer and acceptance in formation of lease contract.

(1) Unless otherwise unambiguously indicated by the language or circumstances, an offer to make a lease contract must be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances.

(2) If the beginning of a requested performance is a reasonable mode of acceptance, an offeror who is not notified of acceptance within a reasonable time may treat the offer as having lapsed before acceptance. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-206(1)(a) and (2).

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Lease contract". Section 2A-103(1)(*l*).

"Notifies". Section 1-201(26).

"Reasonable time". Section 1-204(1) and (2).

§ 25-2A-207. Course of performance or practical construction.

(1) If a lease contract involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection is relevant to determine the meaning of the lease agreement.

(2) The express terms of a lease agreement and any course of performance, as well as any course of dealing and usage of trade, must be construed whenever reasonable as consistent with each other; but if that construction is unreasonable, express terms control course of performance, course of performance controls both course of dealing and usage of trade, and course of dealing controls usage of trade.

(3) Subject to the provisions of G.S. 25-2A-208 on modification and waiver, course of performance is relevant to show a waiver or modification of any term inconsistent with the course of performance. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-208 and 1-205(4).

Changes: Revised to reflect leasing practices and terminology, except that subsection (2) was further revised to make the subsection parallel the provisions of Section 1-205(4) by adding that course of dealing controls usage of trade.

Purposes:

The section should be read in conjunction with Section 2A-208. In particular, although a specific term may control over course of performance as a matter of lease construction under subsection (2), subsection (3) allows the same course of dealing to show a waiver or modification, if Section 2A-208 is satisfied.

Cross References:

Sections 1205(4), 2-208 and 2A-208.

Definitional Cross References:

"Course of dealing". Section 1-205.

"Knowledge". Section 1-201(25).

"Lease agreement". Section 2A-103(1)(k).

"Lease contract". Section 2A-103(1)(*l*).

"Party". Section 1-201(29).
"Term". Section 1-201(42).
"Usage of trade". Section 1-205.

§ 25-2A-208. Modification, rescission and waiver.

(1) An agreement modifying a lease contract needs no consideration to be binding.

(2) A signed lease agreement that excludes modification or rescission except by a signed writing may not be otherwise modified or rescinded, but, except as between merchants, such a requirement on a form supplied by a merchant must be separately signed by the other party.

(3) Although an attempt at modification or rescission does not satisfy the requirements of subsection (2) of this section, it may operate as a waiver.

(4) A party who has made a waiver affecting an executory portion of a lease contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-209.

Changes: Revised to reflect leasing practices and terminology, except that the provisions of subsection 2-209(3) were omitted.

Purposes:

Section 2-209(3) provides that "the requirements of the statute of frauds section of this Article (Section 2-201) must be satisfied if the contract as modified is within its provisions." This provision was not incorporated as it is unfair to allow an oral modification to make the entire lease contract unenforceable, e.g., if the modification takes it a few dollars over the dollar limit. At the same time, the problem could not be solved by providing that the lease contract would still be enforceable in its pre-modification state (if it then satisfied the statute of frauds) since in some cases that might be worse than no enforcement at all. Resolution of the issue is left to the courts based on the facts of each case.

Cross References:

Sections 2-201 and 2-209.

Definitional Cross References:

"Agreement". Section 1-201(3).
"Between merchants". Section 2-104(3).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(*l*).
"Merchant". Section 2-104(1).
"Notification". Section 1-201(26).
"Party". Section 1-201(29).
"Signed". Section 1-201(39).
"Term". Section 1-201(42).
"Writing". Section 1-201(46).

§ 25-2A-209. Lessee under finance lease as beneficiary of supply contract.

(1) The benefit of a supplier's promises to the lessor under the supply contract and of all warranties, whether express or implied, including those of any third party provided in connection with or as part of the supply contract, extends to the lessee to the extent of the lessee's leasehold interest under a finance lease related to the supply contract, but is subject to the terms of the warranty and of the supply contract and all defenses or claims arising therefrom.

(2) The extension of the benefit of a supplier's promises and of warranties to the lessee (G.S. 25-2A-209(1)) does not: (i) modify the rights and obligations of the parties to the supply contract, whether arising therefrom or otherwise, or (ii) impose any duty or liability under the supply contract on the lessee.

(3) Any modification or rescission of the supply contract by the supplier and the lessor is effective between the supplier and the lessee unless, before the modification or rescission, the supplier has received notice that the lessee has entered into a finance lease related to the supply contract. If the modification or rescission is effective between the supplier and the lessee, the lessor is deemed to have assumed, in addition to the obligations of the lessor to the lessee under the lease contract, promises of the supplier to the lessor and warranties that were so modified or rescinded as they existed and were available to the lessee before modification or rescission.

(4) In addition to the extension of the benefit of the supplier's promises and of warranties to the lessee under subsection (1) of this section, the lessee retains all rights that the lessee may have against the supplier which arise from an agreement between the lessee and the supplier or under other law. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: None.

Changes: This section is modeled on Section 9-318, the Restatement (Second) of Contracts §§ 302-315 (1981), and leasing practices. See Earman Oil Co. v. Burroughs Corp., 625 F.2d 1291, 1296-97 (5th Cir. 1980).

Purposes:

1. The function performed by the lessor in a finance lease is extremely limited. Section 2A-103(1)(g). The lessee looks to the supplier of the goods for warranties and the like or, in some cases as to warranties, to the manufacturer if a warranty made by that person is passed on. That expectation is reflected in subsection (1), which is self-executing. As a matter of policy, the operation of this provision may not be excluded, modified or limited; however, an exclusion, modification, or limitation of any term of the supply contract or warranty, including any with respect to rights and remedies, and any defense or claim such as a statute of limitations, effective against the lessor as the acquiring party under the supply contract, is also effective against the lessee as the beneficiary designated under this provision. For example, the supplier is not precluded from excluding or modifying an express or implied warranty under a supply contract. Sections 2-312(2) and 2-316, or Section 2A-214. Further, the supplier is not precluded from limiting the rights and remedies of the lessor and from liquidating damages. Sections 2-718 and 2-719 or Sections 2A-503 and 2A-504. If the supply contract excludes or modifies warranties, limits remedies, or liquidates damages with respect to the lessor, such provisions are enforceable against the lessee as beneficiary. Thus, only selective discrimination against the beneficiaries designated under this section is precluded, i.e., exclusion of the supplier's liability to the lessee with respect to warranties made to the lessor. This section does not affect the development of other law with respect to products liability.

2. Enforcement of this benefit is by action. Sections 2A-103(4) and 1-106(2).

3. The benefit extended by these provisions is not without a price, as this Article also provides in the case of a finance lease that is not a consumer lease that the lessee's promises to the lessor under the lease contract become irrevocable and independent upon the lessee's acceptance of the goods. Section 2A-407.

4. Subsection (2) limits the effect of subsection (1) on the supplier and the lessor by preserving, notwithstanding the transfer of the benefits of the supply contract to the lessee, all of the supplier's and the lessor's rights and obligations with respect to each other and others; it further absolves the lessee of

any duties with respect to the supply contract that might have been inferred from the extension of the benefits thereof.

5. Subsections (2) and (3) also deal with difficult issues related to modification or rescission of the supply contract. Subsection (2) states a rule that determines the impact of the statutory extension of benefit contained in subsection (1) upon the relationship of the parties to the supply contract and, in a limited respect, upon the lessee. This statutory extension of benefit, like that contained in Sections 2A-216 and 2-318, is not a modification of the supply contract by the parties. Thus, subsection (3) states the rules that apply to a modification or rescission of the supply contract by the parties. Subsection (3) provides that a modification or rescission is not effective between the supplier and the lessee if, before the modification or rescission occurs, the supplier received notice that the lessee has entered into the finance lease. On the other hand, if the modification or rescission is effective, then to the extent of the modification or rescission of the benefit or warranty, the lessor by statutory dictate assumes an obligation to provide to the lessee that which the lessee would otherwise lose. For example, assume a reduction in an express warranty from four years to one year. No prejudice to the lessee may occur if the goods perform as agreed. If, however, there is a breach of the express warranty after one year and before four years pass, the lessor is liable. A remedy for any prejudice to the lessee because of the bifurcation of the lessee's recourse resulting from the action of the supplier and the lessor is left to resolution by the courts based on the facts of each case.

6. Subsection (4) makes it clear that the rights granted to the lessee by this section do not displace any rights the lessee otherwise may have against the supplier.

Cross References:

Sections 2A-103(1)(g), 2A-407 and 9-318.

Definitional Cross References:

"Action". Section 1-201(1).
"Finance lease". Section 2A-103(1)(g).
"Leasehold interest". Section 2A-103(1)(m).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notice". Section 1-201(25).
"Party". Section 1-201(29).
"Rights". Section 1-201(36).
"Supplier". Section 2A-103(1)(x).
"Supply contract". Section 2A-103(1)(y).
"Term". Section 1-201(42).

§ 25-2A-210. Express warranties.

(1) Express warranties by the lessor are created as follows:

(a) any affirmation of fact or promise made by the lessor to the lessee which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods will conform to the affirmation or promise.

(b) any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods will conform to the description.

(c) any sample or model that is made part of the basis of the bargain creates an express warranty that the whole of the goods will conform to the sample or model.

(2) It is not necessary to the creation of an express warranty that the lessor use formal words, such as "warrant" or "guarantee", or that the lessor have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the lessor's opinion or commendation of the goods does not create a warranty. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-313.

Changes: Revised to reflect leasing practices and terminology.

Purposes:

All of the express and implied warranties of the Article on Sales (Article 2) are included in this Article, revised to reflect the differences between a sale of goods and a lease of goods. Sections 2A-210 through 2A-216. The lease of goods is sufficiently similar to the sale of goods to justify this decision. Hawkland, The Impact of the Uniform Commercial Code on Equipment Leasing, 1972 Ill.L.F. 446, 459-60. Many state and federal courts have reached the same conclusion.

Value of the goods, as used in subsection (2), includes rental value.

Cross References:

Article 2, esp. Section 2-313, and Sections 2A-210 through 2A-216.

Definitional Cross References:

"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Value". Section 1-201(44).

§ 25-2A-211. Warranties against interference and against infringement; lessee's obligation against infringement.

(1) There is in a lease contract a warranty that for the lease term no person holds a claim to or interest in the goods that arose from an act or omission of the lessor, other than a claim by way of infringement or the like, which will interfere with the lessee's enjoyment of its leasehold interest.

(2) Except in a finance lease there is in a lease contract by a lessor who is a merchant regularly dealing in goods of the kind a warranty that the goods are delivered free of the rightful claim of any person by way of infringement or the like.

(3) A lessee who furnishes specifications to a lessor or a supplier shall hold the lessor and the supplier harmless against any claim by way of infringement of the like that arises out of compliance with the specifications. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-312.

Changes: This section is modeled on the provisions of Section 2-312, with modifications to reflect the limited interest transferred by a lease contract and the total interest transferred by a sale. Section 2-312(2), which is omitted here, is incorporated in Section 2A-214. The warranty of quiet possession was abolished with respect to sales of goods. Section 2-312 official comment 1. Section 2A-211(1) reinstates the warranty of quiet possession with respect to leases. Inherent in the nature of the limited interest transferred by the lease — the right to possession and use of the goods — is the need of the lessee for protection greater than that afforded to the buyer. Since the scope of the protection is limited to claims or interests that arose from acts or omissions of the lessor, the lessor will be in position to evaluate the potential cost, certainly a far better position than that enjoyed by the lessee. Further, to the extent the market will allow, the lessor can attempt to pass on the anticipated additional cost to the lessee in the guise of higher rent.

Purposes:

General language was chosen for subsection (1) that expresses the essence of the lessee's expectation: with an exception for infringement and the like, no person holding a claim or interest that arose from an act or omission of the lessor will be able to interfere with the lessee's use and enjoyment of the goods for the lease term. Subsection (2), like other similar provisions in later sections, excludes the finance lessor from extending this warranty; with few exceptions (Sections 2A-210 and 2A-211(1)), the lessee under a finance lease is to look to the supplier for warranties and the like or, in some cases as to warranties, to the manufacturer if a warranty made by that person is passed on. Subsections (2) and (3) are derived from Section 2-312(3). These subsections, as well as the analogue, should be construed so that applicable principles of law and equity supplement their provisions. Sections 2A-103(4) and 1-103.

Cross References:

Sections 2-312, 2-312(1), 2-312(2), 2-312 official comment 1, 2A-210, 2A-211(1) and 2A-214.

Definitional Cross References:

"Delivery". Section 1-201(14).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(*l*).
"Leasehold interest". Section 2A-103(1)(m).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Merchant". Section 2-104(1).
"Person". Section 1-201(30).
"Supplier". Section 2A-103(1)(x).

§ 25-2A-212. Implied warranty of merchantability.

(1) Except in a finance lease, a warranty that the goods will be merchantable is implied in a lease contract if the lessor is a merchant with respect to goods of that kind.

(2) Goods to be merchantable must be at least such as:

(a) pass without objection in the trade under the description in the lease agreement;

(b) in the case of fungible goods, are of fair average quality within the description;

(c) are fit for the ordinary purposes for which goods of that type are used;

(d) run, within the variation permitted by the lease agreement, of even kind, quality, and quantity within each unit and among all units involved;

(e) are adequately contained, packaged, and labeled as the lease agreement may require; and

(f) conform to any promises or affirmations of fact made on the container or label.

(3) Other implied warranties may arise from course of dealing or usage of trade. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-314.

Changes: Revised to reflect leasing practices and terminology. E.g., Glenn Dick Equip. Co. v. Galey Constr., Inc., 97 Idaho 216, 225, 541 P.2d 1184, 1193 (1975) (implied warranty of merchantability (Article 2) extends to lease transactions).

Definitional Cross References:

"Conforming". Section 2A-103(1)(d).
"Course of dealing". Section 1-205.
"Finance lease". Section 2A-103(1)(g).
"Fungible". Section 1-201(17).
"Goods". Section 2A-103(1)(h).
"Lease Agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(*l*).
"Lessor". Section 2A-103(1)(p).
"Merchant". Section 2-104(1).
"Usage of trade". Section 1-205.

§ 25-2A-213. Implied warranty of fitness for particular purpose.

Except in a finance lease, if the lessor at the time the lease contract is made has reason to know of any particular purpose for which the goods are required and that the lessee is relying on the lessor's skill or judgment to select or furnish suitable goods, there is in the lease contract an implied warranty that the goods will be fit for that purpose. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-315.

Changes: Revised to reflect leasing practices and terminology. E.g., All-States Leasing Co. v. Bass, 96 Idaho 873, 879, 538 P.2d 1177, 1183 (1975) (implied warranty of fitness for a particular purpose (Article 2) extends to lease transactions).

Definitional Cross References:
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Knows". Section 1-201(25).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).

§ 25-2A-214. Exclusion or modification of warranties.

(1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit a warranty must be construed wherever reasonable as consistent with each other; but, subject to the provisions of G.S. 25-2A-202 on parol or extrinsic evidence, negation or limitation is inoperative to the extent that the construction is unreasonable.

(2) Subject to subsection (3) of this section, to exclude or modify the implied warranty of merchantability, or any part of it, the language must mention "merchantability", by a writing, and be conspicuous. Subject to subsection (3) of this section, to exclude or modify any implied warranty of fitness, the exclusion must be by a writing and be conspicuous. Language to exclude all implied warranties of fitness is sufficient if it is in writing, is conspicuous, and states, for example, "There is no warranty that the goods will be fit for a particular purpose."

(3) Notwithstanding subsection (2) of this section, but subject to subsection (4) of this section:

(a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as is", or "with all faults", or by other language that in common understanding calls the lessee's attention to the exclusion of warranties and makes plain that there is no implied warranty, if in writing and conspicuous;

(b) if the lessee before entering into the lease contract has examined the goods or the sample or model as fully as desired or has refused to examine the goods, there is no implied warranty with regard to defects that an examination ought in the circumstances to have revealed; and

(c) an implied warranty may also be excluded or modified by course of dealing, course of performance, or usage of trade.

(4) To exclude or modify a warranty against interference or against infringement (G.S. 25-2A-211) or any part of it, the language must be specific, be by a writing, and be conspicuous, unless the circumstances, including course of performance, course of dealing, or usage of trade, give the lessee reason to know that the goods are being leased subject to a claim or interest of any person. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-316 and 2-312(2).

Changes: Subsection (2) requires that a disclaimer of the warranty of merchantability be conspicuous and in writing as is the case for a disclaimer of the warranty of fitness; this is contrary to the rule stated in Section 2-316(2) with respect to the disclaimer of the warranty of merchantability. This section also provides that to exclude or modify the implied warranty of merchantability, fitness or against interference or infringement the language must be in writing and conspicuous. There are, however, exceptions to the rule. E.g., course of dealing, course of performance, or usage of trade may exclude or modify an implied warranty. Section 2A-214(3)(c). The analogue of Section 2-312(2) has been moved to subsection (4) of this section for a more unified treatment of disclaimers; there is no policy with respect to leases of goods that would justify continuing certain distinctions found in the Article on Sales (Article 2) regarding the treatment of the disclaimer of various warranties. Compare Sections 2-312(2) and 2-316(2). Finally, the example of a disclaimer of the implied warranty of fitness stated in subsection (2) differs from the analogue stated in Section 2-316(2); this example should promote a better understanding of the effect of the disclaimer.

Purposes:

These changes were made to reflect leasing practices. E.g., FMC Finance Corp. v. Murphree, 632 F.2d 413, 418 (5th Cir. 1980) (disclaimer of implied warranty under lease transactions must be conspicuous and in writing). The omission of the provisions of Section 2-316(4) was not substantive. Sections 2A-503 and 2A-504.

Cross References:

Article 2, esp. Sections 2-312(2) and 2-316, and Sections 2A-503 and 2A-504.

Definitional Cross References:

"Conspicuous". Section 1-201(10).
"Course of dealing". Section 1-205.
"Fault". Section 2A-103(1)(f).
"Goods". Section 2A-103(1)(h).
"Knows". Section 1-201(25).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Person". Section 1-201(30).
"Usage of trade". Section 1-205.
"Writing". Section 1-201(46).

§ 25-2A-215. Cumulation and conflict of warranties express or implied.

Warranties, whether express or implied, must be construed as consistent with each other and as cumulative, but if that construction is unreasonable, the intention of the parties determines which warranty is dominant. In ascertaining that intention the following rules apply:

(a) exact or technical specifications displace an inconsistent sample or model or general language of description.

(b) a sample from an existing bulk displaces inconsistent general language of description.

(c) express warranties displace inconsistent implied warranties other than an implied warranty of fitness for a particular purpose. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-317.

Definitional Cross Reference: "Party". Section 1-201(29).

§ 25-2A-216. Third-party beneficiaries of express and implied warranties.

A warranty to or for the benefit of a lessee under this Article, whether express or implied, extends to any natural person who is in the family or household of the lessee or who is a guest in the lessee's home if it is reasonable to expect that such person may use, consume, or be affected by the goods and who is injured in person by breach of the warranty. This section does not displace principles of law and equity that extend a warranty to or for the benefit of a lessee to other persons. The operation of this section may not be excluded, modified, or limited, but an exclusion, modification, or limitation of the warranty, including any with respect to rights and remedies, effective against the lessee is also effective against any beneficiary designated under this section. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-318.

Changes: The provisions of Section 2-318 have been included in this section, modified in two respects: first, to reflect leasing practice, including the special practices of the lessor under a finance lease; second, to reflect and thus codify elements of the official comment to Section 2-318 with respect to the effect of disclaimers and limitations of remedies against third parties.

Purposes:

Alternative A is based on the 1962 version of Section 2-318 and is least favorable to the injured person as the doctrine of privity imposed by other law is abrogated to only a limited extent. Alternatives B and C are based on later additions to Section 2-318 and are more favorable to the injured person. In determining which alternative to select, the state legislature should consider making its choice parallel to the choice it made with respect to Section 2-318, as interpreted by the courts.

The last sentence of each of Alternatives A, B and C does not preclude the lessor from excluding or modifying an express or implied warranty under a lease. Section 2A-214. Further, that sentence does not preclude the lessor from limiting the rights and remedies of the lessee and from liquidating damages. Sections 2A-503 and 2A-504. If the lease excludes or modifies warranties, limits remedies for breach, or liquidates damages with respect to the lessee, such provisions are enforceable against the beneficiaries designated under this section. However, this last sentence forbids selective discrimination against the beneficiaries designated under this section, i.e., exclusion of the lessor's liability to the beneficiaries with respect to warranties made by the lessor to the lessee.

Other law, including the Article on Sales (Article 2), may apply in determining the extent to which a warranty to or for the benefit of the lessor extends to the lessee and third parties. This is in part a function of whether the lessor has bought or leased the goods.

This Article does not purport to change the development of the relationship of the common law, with respect to products liability, including strict liability in tort (as restated in Restatement (Second) of Torts, § 402A (1965)), to the provisions of this Act. Compare Cline v. Prowler Indus. of Maryland, 418 A.2d 968 (Del.1980) and Hawkins Constr. Co. v. Matthews Co., 190 Neb. 546, 209 N.W.2d 643 (1973) with Dippel v. Sciano, 37 Wis.2d 443, 155 N.W.2d 55 (1967).

Cross References:

Article 2, esp. Section 2-318, and Sections 2A-214, 2A-503 and 2A-504.

Definitional Cross References:
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Person". Section 1-201(30).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).

§ 25-2A-217. Identification.

Identification of goods as goods to which a lease contract refers may be made at any time and in any manner explicitly agreed to by the parties. In the absence of explicit agreement, identification occurs:

(a) when the lease contract is made if the lease contract is for a lease of goods that are existing and identified;

(b) when the goods are shipped, marked, or otherwise designated by the lessor as goods to which the lease contract refers, if the lease contract is for a lease of goods that are not existing and identified; or

(c) when the young are conceived, if the lease contract is for a lease of unborn young of animals. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-501.

Changes: This section, together with Section 2A-218, is derived from the provisions of Section 2-501, with changes to reflect lease terminology; however, this section omits as irrelevant to leasing practice the treatment of special property.

Purposes:
With respect to subsection (b) there is a certain amount of ambiguity in the reference to when goods are designated, e.g., when the lessor is both selling and leasing goods to the same lessee/buyer and has marked goods for delivery but has not distinguished between those related to the lease contract and those related to the sales contract. As in Section 2-501(1)(b), this issue has been left to be resolved by the courts, case by case.

Cross References:
Sections 2-501 and 2A-218.

Definitional Cross References:
"Agreement". Section 1-201(3).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(*l*).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).

§ 25-2A-218. Insurance and proceeds.

(1) A lessee obtains an insurable interest when existing goods are identified to the lease contract even though the goods identified are nonconforming and the lessee has an option to reject them.

(2) If a lessee has an insurable interest only by reason of the lessor's identification of the goods, the lessor, until default or insolvency or notification to the lessee that identification is final, may substitute other goods for those identified.

(3) Notwithstanding a lessee's insurable interest under subsections (1) and (2) of this section, the lessor retains an insurable interest until an option to buy has been exercised by the lessee and risk of loss has passed to the lessee.

(4) Nothing in this section impairs any insurable interest recognized under any other statute or rule of law.

(5) The parties by agreement may determine that one or more parties have an obligation to obtain and pay for insurance covering the goods and by agreement may determine the beneficiary of the proceeds of the insurance. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-501.

Changes: This section, together with Section 2A-217, is derived from the provisions of Section 2-501, with changes and additions to reflect leasing practices and terminology.

Purposes:

Subsection (2) states a rule allowing substitution of goods by the lessor under certain circumstances, until default or insolvency of the lessor, or until notification to the lessee that identification is final. Subsection (3) states a rule regarding the lessor's insurable interest that, by virtue of the difference between a sale and a lease, necessarily is different from the rule stated in Section 2-501(2) regarding the seller's insurable interest. For this purpose the option to buy shall be deemed to have been exercised by the lessee when the resulting sale is closed, not when the lessee gives notice to the lessor. Further, subsection (5) is new and reflects the common practice of shifting the responsibility and cost of insuring the goods between the parties to the lease transaction.

Cross References:

Sections 2-501, 2-501(2) and 2A-217.

Definitional Cross References:

"Agreement". Section 1-102(3).
"Buying". Section 2A-103(1)(a).
"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).
"Insolvent". Section 1-201(23).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notification". Section 1-201(26).
"Party". Section 1-201(29).

§ 25-2A-219. Risk of loss.

(1) Except in the case of a finance lease, risk of loss is retained by the lessor and does not pass to the lessee. In the case of a finance lease, risk of loss passes to the lessee.

(2) Subject to the provisions of this Article on the effect of default on risk of loss (G.S. 25-2A-220), if risk of loss is to pass to the lessee and the time of passage is not stated, the following rules apply:

(a) if the lease contract requires or authorizes the goods to be shipped by carrier (i) and it does not require delivery at a particular destination, the risk of loss passes to the lessee when the goods are duly delivered to the carrier; but (ii) if it does require delivery at a particular destination and the goods are there duly tendered while in the possession of the carrier, the risk of loss passes to the lessee when the goods are there duly so tendered as to enable the lessee to take delivery.

(b) if the goods are held by a bailee to be delivered without being moved, the risk of loss passes to the lessee on acknowledgment by the bailee of the lessee's right to possession of the goods.

(c) in any case not within subdivision (a) or (b) of this section, the risk of loss passes to the lessee on the lessee's receipt of the goods if the lessor, or, in the case of a finance lease, the supplier, is a merchant; otherwise the risk passes to the lessee on tender of delivery. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-509(1) through (3).

Changes: Subsection (1) is new. The introduction to subsection (2) is new, but subparagraph (a) incorporates the provisions of Section 2-509(1); subparagraph (b) incorporates the provisions of Section

2-509(2) only in part, reflecting current practice in lease transactions.

Purposes:
Subsection (1) states rules related to retention or passage of risk of loss consistent with current practice in lease transactions. The provisions of subsection (4) of Section 2-509 are not incorporated as they are not necessary. This section does not deal with responsibility for loss caused by the wrongful act of either the lessor or the lessee.

Cross References:
Sections 2-509(1), 2-509(2) and 2-509(4).

Definitional Cross References:
"Delivery". Section 1-201(14).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Merchant". Section 2-104(1).
"Receipt". Section 2-103(1)(c).
"Rights". Section 1-201(36).
"Supplier". Section 2A-103(1)(x).

§ 25-2A-220. Effect of default on risk of loss.

(1) Where risk of loss is to pass to the lessee and the time of passage is not stated:

(a) if a tender or delivery of goods so fails to conform to the lease contract as to give a right of rejection, the risk of their loss remains with the lessor, or, in the case of a finance lease, the supplier, until cure or acceptance.

(b) if the lessee rightfully revokes acceptance, he, to the extent of any deficiency in his effective insurance coverage, may treat the risk of loss as having remained with the lessor from the beginning.

(2) Whether or not risk of loss is to pass to the lessee, if the lessee as to conforming goods already identified to a lease contract repudiates or is otherwise in default under the lease contract, the lessor, or, in the case of a finance lease, the supplier, to the extent of any deficiency in his effective insurance coverage may treat the risk of loss as resting on the lessee for a commercially reasonable time. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-510.

Changes: Revised to reflect leasing practices and terminology. The rule in Section (1)(b) does not allow the lessee under a finance lease to treat the risk of loss as having remained with the supplier from the beginning. This is appropriate given the limited circumstances under which the lessee under a finance lease is allowed to revoke acceptance. Section 2A-517 and Section 2A-516 official comment.

Definitional Cross References:
"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Reasonable time". Section 1-204(1) and (2).
"Rights". Section 1-201(36).
"Supplier". Section 2A-103(1)(x).

§ 25-2A-221. Casualty to identified goods.

If a lease contract requires goods identified when the lease contract is made, and the goods suffer casualty without fault of the lessee, the lessor, or the supplier before delivery, or the goods suffer casualty before risk of loss passes to the lessee pursuant to the lease agreement or G.S. 25-2A-219, then:

(a) if the loss is total, the lease contract is avoided; and

(b) if the loss is partial or the goods have so deteriorated as to no longer conform to the lease contract, the lessee may nevertheless demand inspection and at his option either treat the lease contract as avoided or, except in a finance lease that is not a consumer lease, accept the goods with due allowance from the rent payable for the balance of the lease term for the deterioration or the deficiency in quantity but without further right against the lessor. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-613.

Changes: Revised to reflect leasing practices and terminology.

Purpose:

Due to the vagaries of determining the amount of due allowance (Section 2-613(b)), no attempt was made in subsection (b) to treat a problem unique to lease contracts and installment sales contracts: determining how to recapture the allowance, e.g., application to the first or last rent payments or allocation, pro rata, to all rent payments.

Cross References:

Section 2-613.

Definitional Cross References:

"Conforming". Section 2A-103(1)(d).
"Consumer lease". Section 2A-103(1)(e).
"Delivery". Section 1-201(14).
"Fault". Section 2A-103(1)(f).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-193(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Rights". Section 1-201(36).
"Supplier". Section 2A-103(1)(x).

PART 3.

EFFECT OF LEASE CONTRACT.

§ 25-2A-301. Enforceability of lease contract.

Except as otherwise provided in this Article, a lease contract is effective and enforceable according to its terms between the parties, against purchasers of the goods, and against creditors of the parties. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-201.

Changes: The first sentence of Section 9-201 was incorporated, modified to reflect leasing terminology. The second sentence of Section 9-201 was eliminated as not relevant to leasing practices.

Purposes:

1. This section establishes a general

rule regarding the validity and enforceability of a lease contract. The lease contract is effective and enforceable between the parties and against third parties. Exceptions to this general rule arise where there is a specific rule to the contrary in this Article. Enforceability is, thus, dependent upon the lease contract meeting the requirements of the Statute of Frauds provisions of Section 2A-201. Enforceability is also a function of the lease contract conforming to the principles of construction and interpretation contained in the Article on General Provisions (Article 1). Section 2A-103(4).

2. The effectiveness or enforceability of the lease contract is not dependent upon the lease contract or any financing statement or the like being filed or recorded; however, the priority of the interest of a lessor of fixtures with respect to the interests of certain third parties in such fixtures is subject to the provisions of the Article on Secured Transactions (Article 9). Section 2A-309. Prior to the adoption of this Article filing or recording was not required with respect to leases, only leases intended as security. The definition of security interest, as amended concurrently with the adoption of this Article, more clearly delineates leases and leases intended as security and thus signals the need to file. Section 1-201(37). Those lessors who are concerned about whether the transaction creates a lease or a security interest will continue to file a protective financing statement. Section 9-408. Coogan, Leasing and the Uniform Commercial Code, in Equipment Leasing-Leveraged Leasing 681, 744-46 (2d ed. 1980).

3. Hypothetical: (a) In construing this section it is important to recognize its relationship to other sections in this Article. This is best demonstrated by reference to a hypothetical. Assume that on February 1 A, a manufacturer of combines and other farm equipment, leased a fleet of six combines to B, a corporation engaged in the business of farming, for a 12 month term. Under the lease agreement between A and B, A agreed to defer B's payment of the first two months' rent to April 1. On March 1 B recognized that it would need only four combines and thus subleased two combines to C for an 11 month term.

(b) This hypothetical raises a number of issues that are answered by the sections contained in this part. Since lease is defined to include sublease (Section 2A-103(1)(j) and (w)), this section provides that the prime lease between A and B and the sublease between B and C are enforceable in accordance with their terms, except as otherwise provided in this Article; that exception, in this case, is one of considerable scope.

(c) The separation of ownership, which is in A, and possession, which is in B with respect to four combines and which is in C with respect to two combines, is not relevant. Section 2A-302. A's interest in the six combines cannot be challenged simply because A parted with possession to B, who in turn parted with possession of some of the combines to C. Yet it is important to note that by the terms of Section 2A-302 this conclusion is subject to change if otherwise provided in this Article.

(d) B's entering the sublease with C raises an issue that is treated by this part. In a dispute over the leased combines A may challenge B's right to sublease. The rule is permissive as to transfers of interests under a lease contract, including subleases. Section 2A-303(2). However, the rule has two significant qualifications. If the prime lease contract between A and B prohibits B from subleasing the combines, or makes such a sublease an event of default, Section 2A-303(2) applies; thus, while B's interest under the prime lease may not be transferred under the sublease to C, A may have a remedy pursuant to Section 2A-303(5). Absent a prohibition or default provision in the prime lease contract A might be able to argue that the sublease to C materially increases A's risk; thus, while B's interest under the prime lease may be transferred under the sublease to C, A may have a remedy pursuant to Section 2A-303(5). Section 2A-303(5)(b)(ii).

(e) Resolution of this issue is also a function of the section dealing with the sublease of goods by a prime lessee (Section 2A-305). Subsection (1) of Section 2A-305, which is subject to the rules of Section 2A-303 stated above, provides that C takes subject to the interest of A under the prime lease between A and B. However, there are two exceptions. First, if B is a merchant (Sections 2A-103(3) and 2-104(1)) dealing in goods of that kind and C is a sublessee in the ordinary course of business (Sections 2A-103(1)(o) and 2A-103(1)(n)), C takes free of the prime lease between A and B. Second, if B has rejected the six combines under the prime lease with A, and

B disposes of the goods by sublease to C, C takes free of the prime lease if C can establish good faith. Section 2A-511(4).

(f) If the facts of this hypothetical are expanded and we assume that the prime lease obligated B to maintain the combines, an additional issue may be presented. Prior to entering the sublease, B, in satisfaction of its maintenance covenant, brought the two combines that it desired to sublease to a local independent dealer of A's. The dealer did the requested work for B. C inspected the combines on the dealer's lot after the work was completed. C signed the sublease with B two days later. C, however, was prevented from taking delivery of the two combines as B refused to pay the dealer's invoice for the repairs. The dealer furnished the repair service to B in the ordinary course of the dealer's business. If under applicable law the dealer has a lien on repaired goods in the dealer's possession, the dealer's lien will take priority over B's and C's interests, and also should take priority over A's interest, depending upon the terms of the lease contract and the applicable law. Section 2A-306.

(g) Now assume that C is in financial straits and one of C's creditors obtains a judgment against C. If the creditor levies on C's subleasehold interest in the two combines, who will prevail? Unless the levying creditor also holds a lien covered by Section 2A-306, discussed above, the judgment creditor will take its interest subject to B's rights under the sublease and A's rights under the prime lease. Section 2A-307(1). The hypothetical becomes more complicated if we assume that B is in financial straits and B's creditor holds the judgment. Here the judgment creditor takes subject to the sublease unless the lien attached to the two combines before the sublease contract became enforceable. Section 2A-307(2)(a). However, B's judgment creditor cannot prime A's interest in the goods because, with respect to A, the judgment creditor is a creditor of B in its capacity as lessee under the prime lease between A and B. Thus, here the judgment creditor's interest is subject to the lease between A and B. Section 2A-307(1).

(h) Finally, assume that on April 1 B is unable to pay A the deferred rent then due under the prime lease, but that C is current in its payments under the sublease from B. What effect will B's default under the prime lease between A and B have on C's rights under the sublease between B and C? Section 2A-301 provides that a lease contract is effective against the creditors of either party. Since a lease contract includes a sublease contract (Section 2A-103(1)(l)), the sublease contract between B and C arguably could be enforceable against A, a prime lessor who has extended unsecured credit to B the prime lessee/sublessor, if the sublease contract meets the requirements of Section 2A-201. However, the rule stated in Section 2A-301 is subject to other provisions in this Article. Under Section 2A-305, C, as sublessee, would take subject to the prime lease contract in most cases. Thus, B's default under the prime lease will in most cases lead to A's recovery of the goods from C. Section 2A-523. A and C could provide otherwise by agreement. Section 2A-311. C's recourse will be to assert a claim for damages against B. Sections 2A-211(1) and 2A-508.

4. Relationship Between Sections:

(a) As the analysis of the hypothetical demonstrates, Part 3 of the Article focuses on issues that relate to the enforceability of the lease contract (Sections 2A-301, 2A-302 and 2A-303) and to the priority of various claims to the goods subject to the lease contract (Sections 2A-304, 2A-305, 2A-306, 2A-307, 2A-308, 2A-309, 2A-310, and 2A-311).

(b) This section states a general rule of enforceability, which is subject to specific rules to the contrary stated elsewhere in the Article. Section 2A-302 negates any notion that the separation of title and possession is fraudulent as a rule of law. Finally, Section 2A-303 states rules with respect to the transfer of the lessor's interest (as well as the residual interest in the goods) or the lessee's interest under the lease contract. Qualifications are imposed as a function of various issues, including whether the transfer is the creation or enforcement of a security interest or one that is material to the other party to the lease contract. In addition, a system of rules is created to deal with the rights and duties among assignor, assignee and the other party to the lease contract.

(c) Sections 2A-304 and 2A-305 are twins that deal with good faith transferees of goods subject to the lease contract. Section 2A-304 creates a set of rules with respect to transfers by the lessor of goods subject to a lease contract; the transferee considered is a subsequent lessee of the goods. The priority dispute covered here is between the subsequent lessee and the original lessee of the goods (or persons claiming through the original lessee). Section 2A-305 creates a set of rules with respect to transfers by the lessee of goods subject to a lease contract; the transferees considered are buyers of the goods or sublessees of the goods. The priority dispute covered here is between the transferee and the lessor of the goods (or persons claiming through the lessor).

(d) Section 2A-306 creates a rule with respect to priority disputes between holders of liens for services or materials furnished with respect to goods subject to a lease contract and the lessor or the lessee under that contract. Section 2A-307 creates a rule with respect to priority disputes between the lessee and creditors of the lessor and priority disputes between the lessor and creditors of the lessee.

(e) Section 2A-308 creates a series of rules relating to allegedly fraudulent transfers and preferences. The most significant rule is that set forth in subsection (3) which validates sale-leaseback transactions if the buyer-lessor can establish that he or she bought for value and in good faith.

(f) Sections 2A-309 and 2A-310 create a series of rules with respect to priority disputes between various third parties and a lessor of fixtures or accessions, respectively, with respect thereto.

(g) Finally, Section 2A-311 allows parties to alter the statutory priorities by agreement.

Cross References:

Article 1, especially Section 1-201(37), and Sections 2-104(1), 2A-103(1)(j), 2A-103(1)(*l*), 2A-103(1)(n), 2A-103(1)(o) and 2A-103(1)(w), 2A-103(3), 2A-103(4), 2A-201, 2A-301 through 2A-303, 2A-303(2), 2A-303(5), 2A-304 through 2A-307, 2A-307(1), 2A-307(2)(a), 2A-308 through 2A-311, 2A-508, 2A-511(4), 2A-523, Article 9, especially Sections 9-201 and 9-408.

Definitional Cross References:

"Creditor". Section 1-201(12).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(*l*).
"Party". Section 1-201(29).
"Purchaser". Section 1-201(33).
"Term". Section 1-201(42).

§ 25-2A-302. Title to and possession of goods.

Except as otherwise provided in this Article, each provision of this Article applies whether the lessor or a third party has title to the goods, and whether the lessor, the lessee, or a third party has possession of the goods, notwithstanding any statute or rule of law that possession or the absence of possession is fraudulent. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-202.

Changes: Section 9-202 was modified to reflect leasing terminology and to clarify the law of leases with respect to fraudulent conveyances or transfers.

Purposes:

The separation of ownership and possession of goods between the lessor and the lessee (or a third party) has created problems under certain fraudulent conveyance statutes. See, e.g., In re Ludlum Enters., 510 F.2d 996 (5th Cir. 1975); Suburbia Fed. Sav. & Loan Ass'n v. Bel-Air Conditioning Co., 385 So.2d 1151 (Fla.Dist.Ct.App.1980). This section provides, among other things, that separation of ownership and possession per se does not affect the enforceability of the lease contract. Sections 2A-301 and 2A-308.

Cross References:

Sections 2A-301, 2A-308 and 9-202.

Definitional Cross References:

"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).

§ 25-2A-303. Alienability of party's interest under lease contract or of lessor's residual interest in goods; delegation of performance; transfer of rights.

(1) As used in this section, "creation of a security interest" includes the sale of a lease contract that is subject to Article 9 of this Chapter, Secured Transactions, by reason of G.S. 25-9-102(1)(b).

(2) Except as provided in subsections (3) and (4) of this section, a provision in a lease agreement which (i) prohibits the voluntary or involuntary transfer, including a transfer by sale, sublease, creation, or enforcement of a security interest, or attachment, levy, or other judicial process, of an interest of a party under the lease contract or of the lessor's residual interest in the goods; or (ii) makes such a transfer an event of default, gives rise to the rights and remedies provided in subsection (5) of this section, but a transfer that is prohibited or is an event of default under the lease agreement is otherwise effective.

(3) A provision in a lease agreement which (i) prohibits the creation or enforcement of a security interest in an interest of a party under the lease contract or in the lessor's residual interest in the goods, or (ii) makes such a transfer an event of default, is not enforceable unless, and then only to the extent that, there is an actual transfer by the lessee of the lessee's right of possession or use of the goods in violation of the provision or an actual delegation of a material performance of either party to the lease contract in violation of the provision. Neither the granting nor the enforcement of a security interest in (i) the lessor's interest under the lease contract or (ii) the lessor's residual interest in the goods is a transfer that materially impairs the prospect of obtaining return performance by, materially changes the duty of, or materially increases the burden or risk imposed on, the lessee within the purview of subsection (5) of this section unless, and then only to the extent that, there is an actual delegation of a material performance of the lessor.

(4) A provision in a lease agreement which (i) prohibits a transfer of a right to damages for default with respect to the whole lease contract or of a right to payment arising out of the transferor's due performance of the transferor's entire obligation, or (ii) makes such a transfer an event of default, is not enforceable, and such a transfer is not a transfer that materially impairs the prospect of obtaining return performance by, materially changes the duty of, or materially increases the burden or risk imposed on, the other party to the lease contract within the purview of subsection (5) of this section.

(5) Subject to subsections (3) and (4) of this section:

(a) if a transfer is made which is made an event of default under a lease agreement, the party to the lease contract not making the transfer, unless that party waives the default or otherwise agrees, has the rights and remedies described in G.S. 25-2A-501(2);

(b) if paragraph (a) is not applicable and if a transfer is made that (i) is prohibited under a lease agreement or (ii) materially impairs the prospect of obtaining return performance by, materially changes the duty of, or materially increases the burden or risk imposed on, the other party to the lease contract, unless the party not making the transfer agrees at any time to the transfer in the lease contract or otherwise, then, except as limited by contract, (i) the transferor is liable to the party not making the transfer for damages caused by the transfer to the extent that the damages could not reasonably be prevented by the party not making the transfer and (ii) a court having jurisdiction may grant other appropriate relief, including cancellation of the lease contract or an injunction against the transfer.

(6) A transfer of "the lease" or of "all my rights under the lease", or a transfer in similar general terms, is a transfer of rights and, unless the language or the circumstances, as in a transfer for security, indicate the contrary, the transfer is a delegation of duties by the transferor to the transferee. Acceptance by the transferee constitutes a promise by the transferee to perform those duties. The promise is enforceable by either the transferor or the other party to the lease contract.

(7) Unless otherwise agreed by the lessor and the lessee, a delegation of performance does not relieve the transferor as against the other party of any duty to perform or of any liability for default.

(8) In a consumer lease, to prohibit the transfer of an interest of a party under the lease contract or to make a transfer an event of default, the language must be specific, by a writing, and conspicuous. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-210 and 9-311.

Changes: The provisions of Sections 2-210 and 9-311 were incorporated in this section, with substantial modifications to reflect leasing terminology and practice and to harmonize the principles of the respective provisions, i.e., limitations on delegation of performance on the one hand and alienability of rights on the other. In addition, unlike Section 2-210 which deals only with voluntary transfers, this section deals with involuntary as well as voluntary transfers. Moreover, the principle of Section 9-318(4) denying effectiveness to contractual terms prohibiting assignments of receivables due and to become due also is implemented.

Purposes:

1. Subsection (2) states a rule, consistent with Section 9-311, that voluntary and involuntary transfers of an interest of a party under the lease contract or of the lessor's residual interest, including by way of the creation or enforcement of a security interest, are effective, notwithstanding a provision in the lease agreement prohibiting the transfer or making the transfer an event of default. Although the transfers are effective, the provision in the lease agreement is nevertheless enforceable, but only as provided in subsection (5). Under subsection (5) the prejudiced party is limited to the remedies on "default under the lease contract" in this Article and, except as limited by this Article, as provided in the lease agreement, if the transfer has been made an event of default. Section 2A-501(2). Usually, there will be a specific provision to this effect or a general provision making a breach of a covenant an event of default. In those cases where the transfer is prohibited, but not made an event of default, the prejudiced party may recover damages; or, if the damage remedy would be ineffective adequately to protect that party, the court can order cancellation of the lease contract or enjoin the transfer. This rule that such provisions generally are enforceable is subject to subsections (3) and (4), which make such provisions unenforceable in certain instances.

2. The first such instance is described in subsection (3). A provision in a lease agreement which prohibits the creation or enforcement of a security interest, including sales of lease contracts subject to Article 9 (Sections 9-102(1)(b) and 9-104(f)), or makes it an event of default is generally not enforceable, reflecting

the policy of Section 9-318(4). However, that policy gives way to the doctrine stated in Section 2-210(2), which gives one party to a contract the right to protect itself against an actual delegation (but not just a provision under which delegation might later occur) of a material performance by the other party. Accordingly, such a provision in a lease agreement is enforceable when the transfer delegates a material performance. Generally, as expressly provided in subsection (6), a transfer for security is not a delegation of duties. However, inasmuch as the creation of a security interest includes the sale of a lease contract, if there are then unperformed duties on the part of the lessor/seller, there could be a delegation of duties in the sale, and, if such a delegation actually takes place and is of a material performance, a provision in a lease agreement prohibiting it or making it an event of default would be enforceable, giving rise to the rights and remedies stated in subsection (5). The statute does not define "material." The parties may set standards to determine its meaning. The term is intended to exclude delegations of matters such as accounting to a professional accountant and the performance of, as opposed to the responsibility for, maintenance duties to a person in the maintenance service industry.

3. For similar reasons, the lessor is entitled to protect its residual interest in the goods by prohibiting anyone but the lessee from possessing or using them. Accordingly, under subsection (3) if there is an actual transfer by the lessee of its right of possession or use of the goods in violation of a provision in the lease agreement, such a provision likewise is enforceable, giving rise to the rights and remedies stated in subsection (5). A transfer of the lessee's right of possession or use of the goods resulting from the enforcement of a security interest granted by the lessee in its leasehold interest is a "transfer by the lessee" under this subsection.

4. Finally, subsection (3) protects against a claim that the creation or enforcement of a security interest in the lessor's interest under the lease contract or in the residual interest is a transfer that materially impairs the prospect of obtaining return performance by, materially changes the duty of, or materially increases the burden or risk imposed on the lessee so as to give rise to the rights and remedies stated in subsection (5), unless the transfer involves an actual delegation of a material performance of the lessor.

5. While it is not likely that a transfer by the lessor of its right to payment under the lease contract would impair at a future time the ability of the lessee to obtain the performance due the lessee under the lease contract from the lessor, if under the circumstances reasonable grounds for insecurity as to receiving that performance arise, the lessee may employ the provision of this Article for demanding adequate assurance of due performance and has the remedy provided in that circumstance. Section 2A-401.

6. Sections 9-206 and 9-318(1) through (3) also are relevant. Section 9-206 sanctions an agreement by a lessee not to assert certain types of claims or defenses against the lessor's assignee. Section 9-318(1) through (3) deal with, among other things, the other party's rights against the assignee where Section 9-206(1) does not apply. Since the definition of contract under Section 1-201(11) includes a lease agreement, the definition of account debtor under Section 9-105(1)(a) includes a lessee of goods. As a result, Section 9-206 applies to lease agreements, and there is no need to restate those sections in this Article. The reference to "defenses or claims arising out of a sale" in Section 9-318(1) should be interpreted broadly to include defenses or claims arising out of a lease inasmuch as that section codifies the common law rule with respect to contracts, including lease contracts.

7. Subsection (4) is based upon Section 2-210(2) and Section 9-318(4). It makes unenforceable a prohibition against transfers of certain rights to payment or a provision making the transfer an event of default. It also provides that such transfers do not materially impair the prospect of obtaining return performance by, materially change the duty of, or materially increase the burden or risk imposed on, the other party to the lease contract so as to give rise to the rights and remedies stated in subsection (5). Accordingly, a transfer of a right to payment cannot be prohibited or made an event of default, or be one that materially impairs performance, changes duties or increases risk, if the right is already due or will become due without further performance being required by the party to receive payment. Thus, a lessor can transfer the right to future

payments under the lease contract, including by way of a grant of a security interest, and the transfer will not give rise to the rights and remedies stated in subsection (5) if the lessor has no remaining performance under the lease contract. The mere fact that the lessor is obligated to allow the lessee to remain in possession and to use the goods as long as the lessee is not in default does not mean that there is "remaining performance" on the part of the lessor. Likewise, the fact that the lessor has potential liability under a "non-operating" lease contract for breaches of warranty does not mean that there is "remaining performance." In contrast, the lessor would have "remaining performance" under a lease contract requiring the lessor to regularly maintain and service the goods or to provide "upgrades" of the equipment on a periodic basis in order to avoid obsolescence. The basic distinction is between a mere potential duty to respond which is not "remaining performance," and an affirmative duty to render stipulated performance. Although the distinction may be difficult to draw in some cases, it is instructive to focus on the difference between "operating" and "non-operating" leases as generally understood in the marketplace. Even if there is "remaining performance" under a lease contract, a transfer for security of a right to payment that is made an event of default or that is in violation of a prohibition against transfer does not give rise to the rights and remedies under subsection (5) if it does not constitute an actual delegation of a material performance under subsection (3).

8. The application of either the rule of subsection (3) or the rule of subsection (4) to the grant by the lessor of a security interest in the lessor's right to future payment under the lease contract may produce the same result. Both subsections generally protect security transfers by the lessor in particular because the creation by the lessor of a security interest or the enforcement of that interest generally will not prejudice the lessee's rights if it does not result in a delegation of the lessor's duties. To the contrary, the receipt of loan proceeds or relief from the enforcement of an antecedent debt normally should enhance the lessor's ability to perform its duties under the lease contract. Nevertheless, there are circumstances where relief might be justified. For example, if ownership of the goods is transferred pursuant to enforcement of a security interest to a party whose ownership would prevent the lessee from continuing to possess the goods, relief might be warranted. See 49 U.S.C. § 1401(a) and (b) which places limitations on the operation of aircraft in the United States based on the citizenship or corporate qualification of the registrant.

9. Relief on the ground of material prejudice when the lease agreement does not prohibit the transfer or make it an event of default should be afforded only in extreme circumstances, considering the fact that the party asserting material prejudice did not insist upon a provision in the lease agreement that would protect against such a transfer.

10. Subsection (5) implements the rule of subsection (2). Subsection (2) provides that, even though a transfer is effective, a provision in the lease agreement prohibiting it or making it an event of default may be enforceable as provided in subsection (5). See Brummond v. First National Bank of Clovis, 656 P.2d 884, 35 U.C.C. Rep. Serv. (Callaghan) 1311 (N. Mex. 1983), stating the analogous rule for Section 9-311. If the transfer prohibited by the lease agreement is made an event of default, then, under subsection 5(a), unless the default is waived or there is an agreement otherwise, the aggrieved party has the rights and remedies referred to in Section 2A-501(2), viz. those in this Article and, except as limited in the Article, those provided in the lease agreement. In the unlikely circumstance that the lease agreement prohibits the transfer without making a violation of the prohibition an event of default or, even if there is no prohibition against the transfer, and the transfer is one that materially impairs performance, changes duties, or increases risk (for example, a sublease or assignment to a party using the goods improperly or for an illegal purpose), then subsection 5(b) is applicable. In that circumstance, unless the party aggrieved by the transfer has otherwise agreed in the lease contract, such as by assenting to a particular transfer or to transfers in general, or agrees in some other manner, the aggrieved party has the right to recover damages from the transferor and a court may, in appropriate circumstances, grant other relief, such as cancellation of the lease contract or an injunction against the transfer.

11. If a transfer gives rise to the rights and remedies provided in subsection (5),

the transferee as an alternative may propose, and the other party may accept, adequate cure or compensation for past defaults and adequate assurance of future due performance under the lease contract. Subsection (5) does not preclude any other relief that may be available to a party to the lease contract aggrieved by a transfer subject to an enforceable prohibition, such as an action for interference with contractual relations.

12. Subsection (8) requires that a provision in a consumer lease prohibiting a transfer, or making it an event of default, must be specific, written and conspicuous. See Section 1-201(10). This assists in protecting a consumer lessee against surprise assertions of default.

13. Subsection (6) is taken almost verbatim from the provisions of Section 2-210(4). The subsection states a rule of construction that distinguishes a commercial assignment, which substitutes the assignee for the assignor as to rights and duties, and an assignment for security or financing assignment, which substitutes the assignee for the assignor only as to rights. Note that the assignment for security or financing assignment is a subset of all security interests. Security interest is defined to include "any interest of a buyer of . . . chattel paper". Section 1-201(37). Chattel paper is defined to include a lease. Section 9-105(1)(b). Thus, a buyer of leases is the holder of a security interest in the leases. That conclusion should not influence this issue, as the policy is quite different. Whether a buyer of leases is the holder of a commercial assignment, or an assignment for security or financing assignment should be determined by the language of the assignment or the circumstances of the assignment.

Cross References:

Sections 1-201(11), 1-201(37), 2-210, 2A-401, 9-102(1)(b), 9-104(f), 9-105(1)(a), 9-206, and 9-318.

Definitional Cross References:

"Agreed" and "Agreement". Section 1-201(3).
"Conspicuous". Section 1-201(10).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Lessor's residual interest". Section 2A-103(1)(q).
"Notice". Section 1-201(25).
"Party". Section 1-201(29).
"Person". Section 1-201(30).
"Reasonable time". Section 1-204(1) and (2).
"Rights". Section 1-201(36).
"Term". Section 1-201(42).
"Writing". Section 1-201(46).

§ 25-2A-304. Subsequent lease of goods by lessor.

(1) Subject to G.S. 25-2A-303, a subsequent lessee from a lessor of goods under an existing lease contract obtains, to the extent of the leasehold interest transferred, the leasehold interest in the goods that the lessor had or had power to transfer, and except as provided in subsection (2) of this section and G.S. 25-2A-527(4), takes subject to the existing lease contract. A lessor with voidable title has power to transfer a good leasehold interest to a good faith subsequent lessee for value, but only to the extent set forth in the preceding sentence. If goods have been delivered under a transaction of purchase, the lessor has that power even though:

(a) the lessor's transferor was deceived as to the identity of the lessor;
(b) the delivery was in exchange for a check which is later dishonored;
(c) it was agreed that the transaction was to be a "cash sale"; or
(d) the delivery was procured through fraud punishable as larcenous under the criminal law.

(2) A subsequent lessee in the ordinary course of business from a lessor who is a merchant dealing in goods of that kind to whom the goods were entrusted by the existing lessee of that lessor before the

interest of the subsequent lessee became enforceable against that lessor obtains, to the extent of the leasehold interest transferred, all of that lessor's and the existing lessee's rights to the goods, and takes free of the existing lease contract.

(3) A subsequent lessee from the lessor of goods that are subject to an existing lease contract and are covered by a certificate of title issued under a statute of this State or of another jurisdiction takes no greater rights than those provided both by this section and by the certificate of title statute. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-403.

Changes: While Section 2-403 was used as a model for this section, the provisions of Section 2-403 were significantly revised to reflect leasing practices and to integrate this Article with certificate of title statutes.

Purposes:

1. This section must be read in conjunction with, as it is subject to, the provisions of Section 2A-303, which govern voluntary and involuntary transfers of rights and duties under a lease contract, including the lessor's residual interest in the goods.

2. This section must also be read in conjunction with Section 2-403. This section and Section 2A-305 are derived from Section 2-403, which states a unified policy on good faith purchases of goods. Given the scope of the definition of purchaser (Section 1-201(33)), a person who bought goods to lease as well as a person who bought goods subject to an existing lease from a lessor will take pursuant to Section 2-403. Further, a person who leases such goods from the person who bought them should also be protected under Section 2-403, first because the lessee's rights are derivative and second because the definition of purchaser should be interpreted to include one who takes by lease; no negative implication should be drawn from the inclusion of lease in the definition of purchase in this Article. Section 2A-103(1)(v).

3. There are hypotheticals that relate to an entrustee's unauthorized lease of entrusted goods to a third party that are outside the provisions of Sections 2-403, 2A-304 and 2A-305. Consider a sale of goods by M, a merchant, to B, a buyer. After paying for the goods B allows M to retain possession of the goods as B is short of storage. Before B calls for the goods M leases the goods to L, a lessee. This transaction is not governed by Section 2-403(2) as L is not a buyer in the ordinary course of business. Section 1-201(9). Further, this transaction is not governed by Section 2A-304(2) as B is not an existing lessee. Finally, this transaction is not governed by Section 2A-305(2) as B is not M's lessor. Section 2A-307(2) resolves the potential dispute between B, M and L. By virtue of B's entrustment of the goods to M and M's lease of the goods to L, B has a cause of action against M under the common law. Sections 2A-103(4) and 1-103. See, e.g., Restatement (Second) of Torts §§ 222A — 243. Thus, B is a creditor of M. Sections 2A-103(4) and 1-201(12). Section 2A-307(2) provides that B, as M's creditor, takes subject to M's lease to L. Thus, if L does not default under the lease, L's enjoyment and possession of the goods should be undisturbed. However, B is not without recourse. B's action should result in a judgment against M providing, among other things, a turnover of all proceeds arising from M's lease to L, as well as a transfer of all of M's right, title and interest as lessor under M's lease to L, including M's residual interest in the goods. Section 2A-103(1)(q).

4. Subsection (1) states a rule with respect to the leasehold interest obtained by a subsequent lessee from a lessor of goods under an existing lease contract. The interest will include such leasehold interest as the lessor has in the goods as well as the leasehold interest that the lessor had the power to transfer. Thus, the subsequent lessee obtains unimpaired all rights acquired under the law of agency, apparent agency, ownership or other estoppel, whether based upon statutory provisions or upon case law principles. Sections 2A-103(4) and 1-103. In general, the subsequent lessee takes subject to the existing lease contract, including the existing lessee's rights thereunder. Furthermore, the

subsequent lease contract is, of course, limited by its own terms, and the subsequent lessee takes only to the extent of the leasehold interest transferred thereunder.

5. Subsection (1) further provides that a lessor with voidable title has power to transfer a good leasehold interest to a good faith subsequent lessee for value. In addition, subsections (1)(a) through (d) provide specifically for the protection of the good faith subsequent lessee for value in a number of specific situations which have been troublesome under prior law.

6. The position of an existing lessee who entrusts leased goods to its lessor is not distinguishable from the position of other entrusters. Thus, subsection (2) provides that the subsequent lessee in the ordinary course of business takes free of the existing lease contract between the lessor entrustee and the lessee entruster, if the lessor is a merchant dealing in goods of that kind. Further, the subsequent lessee obtains all of the lessor entrustee's and the lessee entruster's rights to the goods, but only to the extent of the leasehold interest transferred by the lessor entrustee. Thus, the lessor entrustee retains the residual interest in the goods. Section 2A-103(1)(q). However, entrustment by the existing lessee must have occurred before the interest of the subsequent lessee became enforceable against the lessor. Entrusting is defined in Section 2-403(3) and that definition applies here. Section 2A-103(3).

7. Subsection (3) states a rule with respect to a transfer of goods from a lessor to a subsequent lessee where the goods are subject to an existing lease and covered by a certificate of title. The subsequent lessee's rights are no greater than those provided by this section and the applicable certificate of title statute, including any applicable case law construing such statute. Where the relationship between the certificate of title statute and Section 2-403, the statutory analogue to this section, has been construed by a court, that construction is incorporated here. Sections 2A-103(4) and 1-102(1) and (2). The better rule is that the certificate of title statutes are in harmony with Section 2-403 and thus would be in harmony with this section. E.g., Atwood Chevrolet-Olds v. Aberdeen Mun. School Dist., 431 So.2d 926, 928, (Miss.1983); Godfrey v. Gilsdorf, 476 P.2d 3, 6, 86 Nev. 714, 718 (1970); Martin v. Nager, 192 N.J.Super. 189, 197-98, 469 A.2d 519, 523 (Super. Ct. Ch. Div. 1983). Where the certificate of title statute is silent on this issue of transfer, this section will control.

Cross References:

Sections 1-102, 1-103, 1-201(33), 2-403, 2A-103(1)(v), 2A-103(3), 2A-103(4), 2A-303 and 2A-305.

Definitional Cross References:

"Agreed". Section 1-201(3).
"Delivery". Section 1-201(14).
"Entrusting". Section 2-403(3).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(*l*).
"Leasehold interest". Section 2A-103(1)(m).
"Lessee". Section 2A-103(1)(n).
"Lessee in the ordinary course of business". Section 2A-103(1)(o).
"Lessor". Section 2A-103(1)(p).
"Merchant". Section 2-104(1).
"Purchase". Section 2A-103(1)(v).
"Rights". Section 1-201(36).
"Value". Section 1-201(44).

§ 25-2A-305. Sale or sublease of goods by lease [lessee].

(1) Subject to the provisions of G.S. 25-2A-303, a buyer or sublessee from the lessee of goods under an existing lease contract obtains, to the extent of the interest transferred, the leasehold interest in the goods that the lessee had or had power to transfer, and except as provided in subsection (2) of this section and G.S. 25-2A-511(4), takes subject to the existing lease contract. A lessee with a voidable leasehold interest has power to transfer a good leasehold interest to a good faith buyer for value or a good faith sublessee for value, but only to the extent set forth in the preceding sentence. When goods have been delivered under a transaction of lease, the lessee has that power even though:

(a) the lessor was deceived as to the identity of the lessee;

(b) the delivery was in exchange for a check which is later dishonored; or

(c) the delivery was procured through fraud punishable as larcenous under the criminal law.

(2) A buyer in the ordinary course of business or a sublessee in the ordinary course of business from a lessee who is a merchant dealing in goods of that kind to whom the goods were entrusted by the lessor obtains, to the extent of the interest transferred, all of the lessor's and lessee's rights to the goods, and takes free of the existing lease contract.

(3) A buyer or sublessee from the lessee of goods that are subject to an existing lease contract and are covered by a certificate of title issued under a statute of this State or of another jurisdiction takes no greater rights than those provided both by this section and by the certificate of title statute. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-403.

Changes: While Section 2-403 was used as a model for this section, the provisions of Section 2-403 were significantly revised to reflect leasing practice and to integrate this Article with certificate of title statutes.

Purposes:

This section, a companion to Section 2A-304, states the rule with respect to the leasehold interest obtained by a buyer or sublessee from a lessee of goods under an existing lease contract. Cf. Section 2A-304 official comment. Note that this provision is consistent with existing case law, which prohibits the bailee's transfer of title to a good faith purchaser for value under Section 2-403(1). Rohweder v. Aberdeen Product. Credit Ass'n, 765 F.2d 109 (8th Cir.1985).

Subsection (2) is also consistent with existing case law. American Standard Credit, Inc. v. National Cement Co., 643 F.2d 248, 269-70 (5th Cir.1981); but cf. Exxon Co., U.S.A. v. TLW Computer Indus., 37 U.C.C. Rep. Serv. (Callaghan) 1052, 1057-58 (D.Mass.1983). Unlike Section 2A-304(2), this subsection does not contain any requirement with respect to the time that the goods were entrusted to the merchant. In Section 2A-304(2) the competition is between two customers of the merchant lessor; the time of entrusting was added as a criterion to create additional protection to the customer who was first in time: the existing lessee. In subsection (2) the equities between the competing interests were viewed as balanced.

There appears to be some overlap between Section 2-403(2) and Section 2A-305(2) with respect to a buyer in the ordinary course of business. However, an examination of this Article's definition of buyer in the ordinary course of business (Section 2A-103(1)(a)) makes clear that this reference was necessary to treat entrusting in the context of a lease.

Subsection (3) states a rule of construction with respect to a transfer of goods from a lessee to a buyer or sublessee, where the goods are subject to an existing lease and covered by a certificate of title. Cf. Section 2A-304 official comment.

Cross References:

Sections 2-403, 2A-103(1)(a), 2A-304 and 2A-305(2).

Definitional Cross References:

"Buyer". Section 2-103(1)(a).

"Buyer in the ordinary course of business". Section 2A-103(1)(a).

"Delivery". Section 1-201(14).

"Entrusting". Section 2-403(3).

"Good faith". Sections 1-201(19) and 2-103(1)(b).

"Goods". Section 2A-103(1)(h).

"Lease". Section 2A-103(1)(j).

"Lease contract". Section 2A-103(1)(*l*).

"Leasehold interest". Section 2A-103(1)(m).

"Lessee". Section 2A-103(1)(n).

"Lessee in the ordinary course of business". Section 2A-103(1)(o).

"Lessor". Section 2A-103(1)(p).

"Merchant". Section 2-104(1).

"Rights". Section 1-201(36).

"Sale". Section 2-106(1).

"Sublease". Section 2A-103(1)(w).
"Value". Section 1-201(44).

Editor's Note. — The word "lessee" has been inserted in brackets in the section catchline as the word probably intended by the legislature.

§ 25-2A-306. Priority of certain liens arising by operation of law.

If a person in the ordinary course of his business furnishes services or materials with respect to goods subject to a lease contract, a lien upon those goods in the possession of that person given by statute or rule of law for those materials or services takes priority over any interest of the lessor or lessee under the lease contract or this Article unless the lien is created by statute and the statute provides otherwise or unless the lien is created by rule of law and the rule of law provides otherwise. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-310.

Changes: The approach reflected in the provisions of Section 9-310 was included, but revised to conform to leasing terminology and to expand the exception to the special priority granted to protected liens to cover liens created by rule of law as well as those created by statute.

Purposes:
This section should be interpreted to allow a qualified lessor or a qualified lessee to be the competing lienholder if the statute or rule of law so provides. The reference to statute includes applicable regulations and cases; these sources must be reviewed in resolving a priority dispute under this section.

Cross Reference:
Section 9-310.

Definitional Cross References:
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Lien". Section 2A-103(1)(r).
"Person". Section 1-201(30).

§ 25-2A-307. Priority of liens arising by attachment or levy on, security interests in, and other claims to goods.

(1) Except as otherwise provided in G.S. 25-2A-306, a creditor of a lessee takes subject to the lease contract.

(2) Except as otherwise provided in subsections (3) and (4) of this section and in G.S. 25-2A-306 and G.S. 25-2A-308, a creditor of a lessor takes subject to the lease contract unless:

(a) the creditor holds a lien that attached to the goods before the lease contract became enforceable;

(b) the creditor holds a security interest in the goods and the lessee did not give value and receive delivery of the goods without knowledge of the security interest; or

(c) the creditor holds a security interest in the goods which was perfected (G.S. 25-9-303) before the lease contract became enforceable.

(3) A lessee in the ordinary course of business takes the leasehold interest free of a security interest in the goods created by the

lessor even though the security interest is perfected (G.S. 25-9-303) and the lessee knows of its existence.

(4) A lessee other than a lessee in the ordinary course of business takes the leasehold interest free of a security interest to the extent that it secures future advances made after the secured party acquires knowledge of the lease or more than 45 days after the lease contract becomes enforceable, whichever first occurs, unless the future advances are made pursuant to a commitment entered into without knowledge of the lease and before the expiration of the 45-day period. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: None for subsection (1). Subsection (2) is derived from Section 9-301, and subsections (3) and (4) are derived from Section 9-307(1) and (3), respectively.

Changes: The provisions of Sections 9-301 and 9-307(1) and (3) were incorporated, and modified to reflect leasing terminology and the basic concepts reflected in this Article.

Purposes:

1. Subsection (1) states a general rule of priority that a creditor of the lessee takes subject to the lease contract. The term lessee (Section 2A-103(1)(n)) includes sublessee. Therefore, this subsection not only covers disputes between the prime lessor and a creditor of the prime lessee but also disputes between the prime lessor, or the sublessor, and a creditor of the sublessee. Section 2A-301 official comment 3(g). Further, by using the term creditor (Section 1-201(12)), this subsection will cover disputes with a general creditor, a secured creditor, a lien creditor and any representative of creditors. Section 2A-103(4).

2. Subsection (2) states a general rule of priority that a creditor of a lessor takes subject to the lease contract. Note the discussion above with regard to the scope of these rules. Section 2A-301 official comment 3(g). Thus, the section will not only cover disputes between the prime lessee and a creditor of the prime lessor but also disputes between the prime lessee, or the sublessee, and a creditor of the sublessor.

3. To take priority over the lease contract, and the interests derived therefrom, the creditor must come within one of three exceptions stated within the rule. First, subsection (2)(a) provides that where the creditor holds a lien (Section 2A-103(1)(r)) that attached before the lease contract became enforceable (Section 2A-301), the creditor does not take subject to the lease. Second, subsection (2)(b) provides that when the creditor holds a security interest (Section 1-201(37)), whether or not perfected, the creditor has priority over a lessee who did not give value (Section 1-201(44)) and receive delivery of the goods without knowledge (Section 1-201(25)) of the security interest. As to other lessees, under subsection (2)(c) a secured creditor holding a perfected security interest before the time the lease contract became enforceable (Section 2A-301) does not take subject to the lease. With respect to this provision, the lessee in these circumstances is treated like a buyer so that perfection of a purchase money security interest does not relate back (Section 9-301).

4. The rules of this section operate in favor of whichever party to the lease contract may enforce it, even if one party perhaps may not, e.g., under Section 2A-201(1)(b).

5. The rules stated in subsections (2)(b) and (c), and the rule in subsection (3), are best understood by reviewing a hypothetical. Assume that a merchant engaged in the business of selling and leasing musical instruments obtained possession of a truckload of musical instruments on deferred payment terms from a supplier of musical instruments on January 6. To secure payment of such credit the merchant granted the supplier a security interest in the instruments; the security interest was perfected by filing on January 15. The merchant, as lessor, entered into a lease to an individual of one of the musical instruments supplied by the supplier; the lease became enforceable on January 10. Under subsection (2)(b) the lessee will prevail (assuming the lessee qualifies thereunder) unless subsection (c) provides otherwise. Under the rule stated in subsection (2)(c) a priority dispute between the

supplier, as the lessor's secured creditor, and the lessee would be determined by ascertaining on January 10 (the day the lease became enforceable) the validity and perfected status of the security interest in the musical instrument and the enforceability of the lease contract by the lessee. Nothing more appearing, under the rule stated in subsection (2)(c), the supplier's security interest in the musical instrument would not have priority over the lease contract. Moreover, subsection (2) states that its rules are subject to the rules of subsections (3) and (4). Under this hypothetical the lessee should qualify as a "lessee in the ordinary course of business". Section 2A-103(1)(o). Subsection (3) also makes clear that the lessee in the ordinary course of business will win even if he or she knows of the existence of the supplier's security interest.

6. Subsections (3) and (4), which are modeled on the provisions of Section 9-307(1) and (3), respectively, state two exceptions to the priority rule stated in subsection (2) with respect to a creditor who holds a security interest. The lessee in the ordinary course of business will be treated in the same fashion as the buyer in the ordinary course of business, given a priority dispute with a secured creditor over goods subject to a lease contract.

Cross References:

Sections 1-201(12), 1-201(25), 1-201(37), 1-201(44), 2A-103(1)(n), 2A-103(1)(o), 2A-103(1)(r), 2A-103(4), 2A-201(1)(b), 2A-301 official comment 3(g), Article 9, especially Sections 9-301, 9-307(1) and 9-307(3).

Definitional Cross References:

"Creditor". Section 1-201(12).
"Goods". Section 2A-103(1)(h).
"Knowledge" and "Knows". Section 1-201(25).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(*l*).
"Leasehold interest". Section 2A-103(1)(m).
"Lessee". Section 2A-103(1)(n).
"Lessee in the ordinary course of business". Section 2A-103(1)(o).
"Lessor". Section 2A-103(1)(p).
"Lien". Section 2A-103(1)(r).
"Party". Section 1-201(29).
"Pursuant to commitment". Section 2A-103(3).
"Security interest". Section 1-201(37).

§ 25-2A-308. Special rights of creditors.

(1) A creditor of a lessor in possession of goods subject to a lease contract may treat the lease contract as void if as against the creditor retention of possession by the lessor is fraudulent under any statute or rule of law, but retention of possession in good faith and current course of trade by the lessor for a commercially reasonable time after the lease contract becomes enforceable is not fraudulent.

(2) Nothing in this Article impairs the rights of creditors of a lessor if the lease contract (a) becomes enforceable, not in current course of trade but in satisfaction of or as security for a preexisting claim for money, security, or the like, and (b) is made under circumstances which under any statute or rule of law apart from this Article would constitute the transaction a fraudulent transfer or voidable preference.

(3) A creditor of a seller may treat a sale or an identification of goods to a contract for sale as void if as against the creditor retention of possession by the seller is fraudulent under any statute or rule of law, but retention of possession of the goods pursuant to a lease contract entered into by the seller as lessee and the buyer as lessor in connection with the sale or identification of the goods is not fraudulent if the buyer bought for value and in good faith. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-402(2) and (3)(b).

Changes: Rephrased and new material added to conform to leasing terminology and practice.

Purposes:
Subsection (1) states a general rule of avoidance where the lessor has retained possession of goods if such retention is fraudulent under any statute or rule of law. However, the subsection creates an exception under certain circumstances for retention of possession of goods for a commercially reasonable time after the lease contract becomes enforceable.

Subsection (2) also preserves the possibility of an attack on the lease by creditors of the lessor if the lease was made in satisfaction of or as security for a pre-existing claim, and would constitute a fraudulent transfer or voidable preference under other law.

Finally, subsection (3) states a new rule with respect to sale-leaseback transactions, i.e., transactions where the seller sells goods to a buyer but possession of the goods is retained by the seller pursuant to a lease contract between the buyer as lessor and the seller as lessee. Notwithstanding any statute or rule of law that would treat such retention as fraud, whether per se, prima facie, or otherwise, the retention is not fraudulent if the buyer bought for value (Section 1-201(44)) and in good faith (Sections 1-201(19) and 2-103(1)(b)). Section 2A-103(3) and (4). This provision overrides Section 2-402(2) to the extent it would otherwise apply to a sale-leaseback transaction.

Cross References:
Sections 1-201(19), 1-201(44), 2-402(2) and 2A-103(4).

Definitional Cross References:
"Buyer". Section 2-103(1)(a).
"Contract". Section 1-201(11).
"Creditor". Section 1-201(12).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Money". Section 1-201(24).
"Reasonable time". Section 1-204(1) and (2).
"Rights". Section 1-201(36).
"Sale". Section 2-106(1).
"Seller". Section 2-103(1)(d).
"Value". Section 1-201(44).

§ 25-2A-309. Lessor's and lessee's rights when goods become fixtures.

(1) In this section:

(a) goods are "fixtures" when they become so related to particular real estate that an interest in them arises under real estate law;

(b) a "fixture filing" is the filing, in the office where a mortgage on the real estate would be filed or recorded, of a financing statement covering goods that are or are to become fixtures and conforming to the requirements of G.S. 25-9-402(5);

(c) a lease is a "purchase money lease" unless the lessee has possession or use of the goods or the right to possession or use of the goods before the lease agreement is enforceable;

(d) a mortgage is a "construction mortgage" to the extent it secures an obligation incurred for the construction of an improvement on land including the acquisition cost of the land, if the recorded writing so indicates; and

(e) "encumbrance" includes real estate mortgages and other liens on real estate and all other rights in real estate that are not ownership interests.

(2) Under this Article a lease may be of goods that are fixtures or may continue in goods that become fixtures, but no lease exists

under this Article of ordinary building materials incorporated into an improvement on land.

(3) This Article does not prevent creation of a lease of fixtures pursuant to real estate law.

(4) The perfected interest of a lessor of fixtures has priority over a conflicting interest of an encumbrancer or owner of the real estate if:

(a) the lease is a purchase money lease, the conflicting interest of the encumbrancer or owner arises before the goods become fixtures, the interest of the lessor is perfected by a fixture filing before the goods become fixtures or within 10 days thereafter, and the lessee has an interest of record in the real estate or is in possession of the real estate; or

(b) the interest of the lessor is perfected by a fixture filing before the interest of the encumbrancer or owner is of record, the lessor's interest has priority over any conflicting interest of a predecessor in title of the encumbrancer or owner, and the lessee has an interest of record in the real estate or is in possession of real estate.

(5) The interest of a lessor of fixtures, whether or not perfected, has priority over the conflicting interest of an encumbrancer or owner of the real estate if:

(a) the fixtures are readily removable factory or office machines, readily removable equipment that is not primarily used or leased for use in the operation of the real estate, or readily removable replacements of domestic appliances that are goods subject to a consumer lease, and before the goods become fixtures, the lease contract is enforceable; or

(b) the conflicting interest is a lien on the real estate obtained by legal or equitable proceedings after the lease contract is enforceable; or

(c) the encumbrancer or owner has consented in writing to the lease or has disclaimed an interest in the goods as fixtures; or

(d) the lessee has a right to remove the goods as against the encumbrancer or owner. If the lessee's right to remove terminates, the priority of the interest of the lessor continues for a reasonable time.

(6) Notwithstanding subsection (4)(a) of this section but otherwise subject to subsections (4) and (5) of this section, the interest of a lessor of fixtures, including the lessor's residual interest, is subordinate to the conflicting interest of an encumbrancer of the real estate under a construction mortgage recorded before the goods become fixtures if the goods become fixtures before the completion of the construction. To the extent given to refinance a construction mortgage, the conflicting interest of an encumbrancer of the real estate under a mortgage has this priority to the same extent as the encumbrancer of the real estate under the construction mortgage.

(7) In cases not within the preceding subsections, priority between the interest of a lessor of fixtures, including the lessor's residual interest, and the conflicting interest of an encumbrancer or owner of the real estate who is not the lessee is determined by the priority rules governing conflicting interests in real estate.

(8) If the interest of a lessor of fixtures, including the lessor's residual interest, has priority over all conflicting interests of all owners and encumbrancers of the real estate, the lessor or the les-

see may (i) on default, expiration, termination, or cancellation of the lease agreement but subject to the lease agreement and this Article, or (ii) if necessary to enforce other rights and remedies of the lessor or lessee under this Article, remove the goods from the real estate, free and clear of all conflicting interests of all owners and encumbrancers of the real estate, but the lessor or lessee must reimburse any encumbrancer or owner of the real estate who is not the lessee and who has not otherwise agreed for the cost of repair of any physical injury, but not for any diminution in value of the real estate caused by the absence of the goods removed or by any necessity of replacing them. A person entitled to reimbursement may refuse permission to remove until the party seeking removal gives adequate security for the performance of this obligation.

(9) Even though the lease agreement does not create a security interest, the interest of a lessor of fixtures, including the lessor's residual interest, is perfected by filing a financing statement as a fixture filing for leased goods that are or are to become fixtures in accordance with the relevant provisions of the Article on Secured Transactions (Article 9). (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-313.

Changes: Revised to reflect leasing terminology and to add new material.

Purposes:

1. While Section 9-313 provided a model for this section, certain provisions were substantially revised.

2. Section 2A-309(1)(c), which is new, defines purchase money lease to exclude leases where the lessee had possession or use of the goods or the right thereof before the lease agreement became enforceable. This term is used in subsection (4)(a) as one of the conditions that must be satisfied to obtain priority over the conflicting interest of an encumbrancer or owner of the real estate.

3. Section 2A-309(4), which states one of several priority rules found in this section, deletes reference to office machines and the like (Section 9-313(4)(c)) as well as certain liens (Section 9-313(4)(d)). However, these items are included in subsection (5), another priority rule that is more permissive than the rule found in subsection (4) as it applies whether or not the interest of the lessor is perfected. In addition, subsection (5)(a) expands the scope of the provisions of Section 9-313(4)(c) to include readily removable equipment not primarily used or leased for use in the operation of real estate; the qualifier is intended to exclude from the expanded rule equipment integral to the operation of real estate, e.g., heating and air conditioning equipment.

4. The rule stated in subsection (7) is more liberal than the rule stated in Section 9-313(7) in that issues of priority not otherwise resolved in this subsection are left for resolution by the priority rules governing conflicting interests in real estate, as opposed to the Section 9-313(7) automatic subordination of the security interest in fixtures. Note that, for the purpose of this section, where the interest of an encumbrancer or owner of the real estate is paramount to the intent of the lessor, the latter term includes the residual interest of the lessor.

5. The rule stated in subsection (8) is more liberal than the rule stated in Section 9-313(8) in that the right of removal is extended to both the lessor and the lessee and the occasion for removal includes expiration, termination or cancellation of the lease agreement, and enforcement of rights and remedies under this Article, as well as default. The new language also provides that upon removal the goods are free and clear of conflicting interests of owners and encumbrancers of the real estate.

6. Finally, subsection (9) provides a mechanism for the lessor of fixtures to perfect its interest by filing a financing statement under the provisions of the Article on Secured Transactions (Article 9), even though the lease agreement does not create a security interest. Section 1-201(37). The relevant provisions of Article 9 must be interpreted permis-

sively to give effect to this mechanism as it implicitly expands the scope of Article 9 so that its filing provisions apply to transactions that create a lease of fixtures, even though the lease agreement does not create a security interest. This mechanism is similar to that provided in Section 2-326(3)(c) for the seller of goods on consignment, even though the consignment is not "intended as security". Section 1-201(37). Given the lack of litigation with respect to the mechanism created for consignment sales, this new mechanism should prove effective.

Cross References:

Sections 1-201(37), 2A-309(1)(c), 2A-309(4), Article 9, especially Sections 9-313, 9-313(4)(c), 9-313(4)(d), 9-313(7), 9-313(8) and 9-408.

Definitional Cross References:

"Agreed". Section 1-201(3).
"Cancellation". Section 2A-103(1)(b).
"Conforming". Section 2A-103(1)(d).
"Consumer lease". Section 2A-103(1)(e).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Lien". Section 2A-103(1)(r).
"Mortgage". Section 9-105(1)(j).
"Party". Section 1-201(29).
"Person". Section 1-201(30).
"Reasonable time". Section 1-204(1) and (2).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Security interest". Section 1-201(37).
"Termination". Section 2A-103(1)(z).
"Value". Section 1-201(44).
"Writing". Section 1-201(46).

§ 25-2A-310. Lessor's and lessee's rights when goods become accessions.

(1) Goods are "accessions" when they are installed in or affixed to other goods.

(2) The interest of a lessor or a lessee under a lease contract entered into before the goods became accessions is superior to all interests in the whole except as stated in subsection (4) of this section.

(3) The interest of a lessor or a lessee under a lease contract entered into at the time or after the goods became accessions is superior to all subsequently acquired interests in the whole except as stated in subsection (4) of this section but is subordinate to interests in the whole existing at the time the lease contract was made unless the holders of such interests in the whole have in writing consented to the lease or disclaimed an interest in the goods as part of the whole.

(4) The interest of a lessor or a lessee under a lease contract described in subsection (2) or (3) of this section is subordinate to the interest of:

(a) a buyer in the ordinary course of business or a lessee in the ordinary course of business of any interest in the whole acquired after the goods became accessions; or

(b) a creditor with a security interest in the whole perfected before the lease contract was made to the extent that the creditor makes subsequent advances without knowledge of the lease contract.

(5) When under subsections (2) or (3) and (4) of this section, a lessor or a lessee of accessions holds an interest that is superior to all interests in the whole, the lessor or the lessee may:

(a) on default, expiration, termination, or cancellation of the lease contract by the other party but subject to the provisions of the lease contract and this Article; or

(b) if necessary to enforce his other rights and remedies under this Article, remove the goods from the whole, free and clear of all interests in the whole, but he must reimburse any holder of an interest in the whole who is not the lessee and who has not otherwise agreed for the cost of repair of any physical injury but not for any diminution in value of the whole caused by the absence of the goods removed or by any necessity for replacing them. A person entitled to reimbursement may refuse permission to remove until the party seeking removal gives adequate security for the performance of this obligation. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-314.

Changes: Revised to reflect leasing terminology and to add new material.

Purposes:

Subsections (1) and (2) restate the provisions of subsection (1) of Section 9-314 to clarify the definition of accession and to add leasing terminology to the priority rule that applies when the lease is entered into before the goods become accessions. Subsection (3) restates the provisions of subsection (2) of Section 9-314 to add leasing terminology to the priority rule that applies when the lease is entered into on or after the goods become accessions. Unlike the rule with respect to security interests, the lease is merely subordinate, not invalid.

Subsection (4) creates two exceptions to the priority rules stated in subsections (2) and (3). Subsection (4) deletes the special priority rule found in the provisions of Section 9-314(3)(b) as the interests of the lessor and lessee are entitled to greater protection.

Finally, subsection (5) is modeled on the provisions of Section 9-314(4) with respect to removal of accessions, restated to reflect the parallel changes in Section 2A-309(8).

Neither this section nor Section 9-314 governs where the accession to the goods is not subject to the interest of a lessor or a lessee under a lease contract and is not subject to the interest of a secured party under a security agreement. This issue is to be resolved by the courts, case by case.

Cross References:

Sections 2A309(8), 9-314(1), 9-314(2), 9-314(3)(b), 9-314(4).

Definitional Cross References:

"Agreed". Section 1-201(3).
"Buyer in the ordinary course of business". Section 2A-103(1)(a).
"Cancellation". Section 2A-103(1)(b).
"Creditor". Section 1-201(12).
"Goods". Section 2A-103(1)(h).
"Holder". Section 1-201(20).
"Knowledge". Section 1-201(25).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessee in the ordinary course of business". Section 2A-103(1)(o).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).
"Person". Section 1-201(30).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Security interest". Section 1-201(37).
"Termination". Section 2A-103(1)(z).
"Value". Section 1-201(44).
"Writing". Section 1-201(46).

PART 4.

PERFORMANCE OF LEASE CONTRACT: REPUDIATED, SUBSTITUTED, AND EXCUSED.

§ 25-2A-401. Insecurity: adequate assurance of performance.

(1) A lease contract imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired.

(2) If reasonable grounds for insecurity arise with respect to the performance of either party, the insecure party may demand in writing adequate assurance of due performance. Until the insecure party receives that assurance, if commercially reasonable, the insecure party may suspend any performance for which he has not already received the agreed return.

(3) A repudiation of the lease contract occurs if assurance of due performance adequate under the circumstances of the particular case is not provided to the insecure party within a reasonable time, not to exceed 30 days after receipt of a demand by the other party.

(4) Between merchants, the reasonableness of grounds for insecurity and the adequacy of any assurance offered must be determined according to commercial standards.

(5) Acceptance of any nonconforming delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-609.

Changes: Revised to reflect leasing practices and terminology. Note that in the analogue to subsection (3) (Section 2-609(4)), the adjective "justified" modifies demand. The adjective was deleted here as unnecessary, implying no substantive change.

Definitional Cross References:
"Aggrieved party". Section 1-201(2).
"Agreed". Section 1-201(3).
"Between merchants". Section 2-104(3).
"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Lease contract". Section 2A-103(1)(*l*).
"Party". Section 1-201(29).
"Reasonable time". Section 1-204(1) and (2).
"Receipt". Section 2-103(1)(c).
"Rights". Section 1-201(36).
"Writing". Section 1-201(46).

§ 25-2A-402. Anticipatory repudiation.

If either party repudiates a lease contract with respect to a performance not yet due under the lease contract, the loss of which performance will substantially impair the value of the lease contract to the other, the aggrieved party may:

(a) for a commercially reasonable time, await retraction of repudiation and performance by the repudiating party;

(b) make demand pursuant to G.S. 25-2A-401 and await assurance of future performance adequate under the circumstances of the particular case; or

(c) resort to any right or remedy upon default under the lease contract or this Article, even though the aggrieved party has notified the repudiating party that the aggrieved party would await the repudiating party's performance and assurance and has urged retraction. In addition, whether or not the aggrieved party is pursuing one of the foregoing remedies, the aggrieved party may suspend performance or, if the aggrieved party is the lessor, proceed in accordance with the provisions of this Article on the lessor's right to identify goods to the lease contract notwithstanding default or to salvage unfinished goods (G.S. 25-2A-524). (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-610.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:
"Aggrieved party". Section 1-201(2).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(*l*).
"Lessor". Section 2A-103(1)(p).
"Notifies". Section 1-201(26).
"Party". Section 1-201(29).
"Reasonable time". Section 1-204(1) and (2).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Value". Section 1-201(44).

§ 25-2A-403. Retraction of anticipatory repudiation.

(1) Until the repudiating party's next performance is due, the repudiating party can retract the repudiation unless, since the repudiation, the aggrieved party has cancelled the lease contract or materially changed the aggrieved party's position or otherwise indicated that the aggrieved party considers the repudiation final.

(2) Retraction may be by any method that clearly indicates to the aggrieved party that the repudiating party intends to perform under the lease contract and includes any assurance demanded under G.S. 25-2A-401.

(3) Retraction reinstates a repudiating party's rights under a lease contract with due excuse and allowance to the aggrieved party for any delay occasioned by the repudiation. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-611.

Changes: Revised to reflect leasing practices and terminology. Note that in the analogue to subsection (2) (Section 2-611(2)) the adjective "justifiably" modifies demanded. The adjective was deleted here (as it was in Section 2A-401) as unnecessary, implying no substantive change.

Definitional Cross References:
"Aggrieved party". Section 1-201(2).
"Cancellation". Section 2A-103(1)(b).
"Lease contract". Section 2A-103(1)(*l*).
"Party". Section 1-201(29).
"Rights". Section 1-201(36).

§ 25-2A-404. Substituted performance.

(1) If without fault of the lessee, the lessor and the supplier, the agreed berthing, loading, or unloading facilities fail, or the agreed type of carrier becomes unavailable or the agreed manner of delivery otherwise becomes commercially impracticable, but a commercially reasonable substitute is available, the substitute performance shall be tendered and accepted.

(2) If the agreed means or manner of payment fails because of domestic or foreign governmental regulation:

(a) the lessor may withhold or stop delivery or cause the supplier to withhold or stop delivery unless the lessee provides a means or manner of payment that is commercially a substantial equivalent; and

(b) if delivery has already been taken, payment by the means or in the manner provided by the regulation discharges the lessee's obligation unless the regulation is discriminatory, oppressive, or predatory. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-614.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:
"Agreed". Section 1-201(3).
"Delivery". Section 1-201(14).
"Fault". Section 2A-103(1)(f).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Supplier". Section 2A-103(1)(x).

§ 25-2A-405. Excused performance.

Subject to G.S 25-2A-404 on substituted performance, the following rules apply:

(a) delay in delivery or nondelivery in whole or in part by a lessor or a supplier who complies with paragraphs (b) and (c) is not a default under the lease contract if performance as agreed has been made impracticable by the occurrence of a contingency, the nonoccurrence of which was a basic assumption on which the lease contract was made, or by compliance in good faith with any applicable foreign or domestic governmental regulation or order, whether or not the regulation or order later proves to be invalid.

(b) if the causes mentioned in paragraph (a) affect only part of the lessor's or the supplier's capacity to perform, he shall allocate production and deliveries among his customers but at his option may include regular customers not then under contract for sale or lease as well as his own requirements for further manufacture. He may so allocate in any manner that is fair and reasonable.

(c) the lessor seasonably shall notify the lessee and in the case of a finance lease the supplier seasonably shall notify the lessor and the lessee, if known, that there will be delay or nondelivery and, if allocation is required under paragraph (b), of the estimated quota thus made available for the lessee. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-615.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:
"Agreed". Section 1-201(3).
"Contract". Section 1-201(11).
"Delivery". Section 1-201(14).
"Finance lease". Section 2A-103(1)(g).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Knows". Section 1-201(25).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notifies". Section 1-201(26).
"Sale". Section 2-106(1).
"Seasonably". Section 1-204(3).
"Supplier". Section 2A-103(1)(x).

§ 25-2A-406. Procedure on excused performance.

(1) If the lessee receives notification of a material or indefinite delay or an allocation justified under G.S. 25-2A-405, the lessee may, by written notification to the lessor as to any goods involved, and with respect to all of the goods if under an installment lease contract, the value of the whole lease contract is substantially impaired (G.S. 25-2A-510):

(a) terminate the lease contract (G.S. 25-2A-505(2)); or

(b) except in a finance lease that is not a consumer lease, modify the lease contract by accepting the available quota in substitution, with due allowance from the rent payable for the balance of the lease term for the deficiency but without further right against the lessor.

(2) If, after receipt of a notification from the lessor under G.S. 25-2A-405, the lessee fails so to modify the lease agreement within a reasonable time not exceeding 30 days, the lease contract lapses with respect to any deliveries affected. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-616(1) and (2).

Changes: Revised to reflect leasing practices and terminology. Note that subsection 1(a) allows the lessee under a lease, including a finance lease, the right to terminate the lease for excused performance (Sections 2A-404 and 2A-405). However, subsection 1(b), which allows the lessee the right to modify the lease for excused performance, excludes a finance lease that is not a consumer lease. This exclusion is compelled by the same policy that led to codification of provisions with respect to irrevocable promises. Section 2A-407.

Definitional Cross References:
"Consumer lease". Section 2A-103(1)(e).
"Delivery". Section 1-201(14).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Installment lease contract". Section 2A-103(1)(i).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notice". Section 1-201(25).
"Reasonable time". Section 1-204(1) and (2).
"Receipt". Section 2-103(1)(c).
"Rights". Section 1-201(36).
"Termination". Section 2A-103(1)(z).
"Value". Section 1-201(44).
"Written". Section 1-201(46).

§ 25-2A-407. Irrevocable promises: finance leases.

(1) In the case of a finance lease that is not a consumer lease, the lessee's promises under the lease contract become irrevocable and independent upon the lessee's acceptance of the goods.

(2) A promise that has become irrevocable and independent under subsection (1) of this section:

(a) is effective and enforceable between the parties, and by or against third parties including assignees of the parties; and

(b) is not subject to cancellation, termination, modification, repudiation, excuse, or substitution without the consent of the party to whom the promise runs.

(3) This section does not affect the validity under any other law of a covenant in any lease contract making the lessee's promises irrevocable and independent upon the lessee's acceptance of the goods. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: None.

Purposes:

1. This section extends the benefits of the classic "hell or high water" clause to a finance lease that is not a consumer lease. This section is self-executing; no special provision need be added to the contract. This section makes covenants in a finance lease irrevocable and independent due to the function of the finance lessor in a three party relationship: the lessee is looking to the supplier to perform the essential covenants and warranties. Section 2A-209. Thus, upon the lessee's acceptance of the goods the lessee's promises to the lessor under the lease contract become irrevocable and independent. The provisions of this section remain subject to the obligation of good faith (Sections 2A-103(4) and 1-203), and the lessee's revocation of acceptance (Section 2A-517).

2. The section requires the lessee to perform even if the lessor's performance after the lessee's acceptance is not in accordance with the lease contract; the lessee may, however, have and pursue a cause of action against the lessor, e.g., breach of certain limited warranties (Sections 2A-210 and 2A-211(1)). This is appropriate because the benefit of the supplier's promises and warranties to the lessor under the supply contract and, in some cases, the warranty of a manufacturer who is not the supplier, is extended to the lessee under the finance lease. Section 2A-209. Despite this balance, this section excludes a finance lease that is a consumer lease. That a consumer be obligated to pay notwithstanding defective goods or the like is a principle that is not tenable under case law (Unico v. Owen, 50 N.J. 101, 232 A.2d 405 (1967)), state statute (Unif. Consumer Credit Code §§ 3.403-.405, 7A U.L.A. 126-31 (1974), or federal statute (15 U.S.C. § 1666i (1982)).

3. The relationship of the three parties to a transaction that qualifies as a finance lease is best demonstrated by a hypothetical. A, the potential lessor, has been contracted by B, the potential lessee, to discuss the lease of an expensive line of equipment that B has recently placed an order for with C, the manufacturer of such goods. The negotiation is completed and A, as lessor, and B, as lessee, sign a lease of the line of equipment for a 60-month term. B, as buyer, assigns the purchase order with C to A. If this transaction creates a lease (Section 2A-103(1)(j)), this transaction should qualify as a finance lease. Section 2A-103(1)(g).

4. The line of equipment is delivered by C to B's place of business. After installation by C and testing by B, B accepts the goods by signing a certificate of delivery and acceptance, a copy of which is sent by B to A and C. One year later the line of equipment malfunctions and B falls behind in its manufacturing schedule.

5. Under this Article, because the lease is a finance lease, no warranty of fitness or merchantability is extended by A to B. Sections 2A-212(1) and 2A-213. Absent an express provision in the lease agreement, application of Sec-

tion 2A-210 or Section 2A-211(1), or application of the principles of law and equity, including the law with respect to fraud, duress, or the like (Sections 2A-103(4) and 1-103), B has no claim against A. B's obligation to pay rent to A continues as the obligation became irrevocable and independent when B accepted the line of equipment (Section 2A-407(1)). B has no right to set-off with respect to any part of the rent still due under the lease. Section 2A-508(6). However, B may have another remedy. Despite the lack of privity between B and C (the purchase order with C having been assigned by B to A), B may have a claim against C. Section 2A-209(1).

6. This section does not address whether a "hell or high water" clause, i.e., a clause that is to the effect of this section, is enforceable if included in a finance lease that is a consumer lease or a lease that is not a finance lease. That issue will continue to be determined by the facts of each case and other law which this section does not affect. Sections 2A-104, 2A-103(4), 9-206 and 9-318. However, with respect to finance leases that are not consumer leases courts have enforced "hell or high water" clauses. In re O.P.M. Leasing Servs., 21 Bankr. 993, 1006 (Bankr. S.D.N.Y. 1982).

7. Subsection (2) further provides that a promise that has become irrevocable and independent under subsection (1) is enforceable not only between the parties but also against third parties. Thus, the finance lease can be transferred or assigned without disturbing enforceability. Further, subsection (2) also provides that the promise cannot, among other things, be cancelled or terminated without the consent of the lessor.

Cross References:

Sections 1-103, 1-203, 2A-103(1)(g), 2A-103(1)(j), 2A-103(4), 2A-104, 2A-209, 2A-209(1), 2A-210, 2A-211(1), 2A-212(1), 2A-213, 2A-517(1)(b), 9-206 and 9-318.

Definitional Cross References:

"Cancellation". Section 2A-103(1)(b).
"Consumer lease". Section 2A-103(1)(e).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Party". Section 1-201(29).
"Termination". Section 2A-103(1)(z).

PART 5.

DEFAULT.

A. In General.

§ 25-2A-501. Default: procedure.

(1) Whether the lessor or the lessee is in default under a lease contract is determined by the lease agreement and this Article.

(2) If the lessor or the lessee is in default under the lease contract, the party seeking enforcement has rights and remedies as provided in this Article and, except as limited by this Article, as provided in the lease agreement.

(3) If the lessor or the lessee is in default under the lease contract, the party seeking enforcement may reduce the party's claim to judgment, or otherwise enforce the lease contract by self-help or any available judicial procedure or nonjudicial procedure, including administrative proceeding, arbitration, or the like, in accordance with this Article.

(4) Except as otherwise provided in G.S. 25-1-106(1) or this Article or the lease agreement, the rights and remedies referred to in subsections (2) and (3) of this section are cumulative.

(5) If the lease agreement covers both real property and goods, the party seeking enforcement may proceed under this Part as to the goods, or under other applicable law as to both the real property

and the goods in accordance with that party's rights and remedies in respect of the real property, in which case this Part does not apply. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-501.

Changes: Substantially revised.

Purposes:

1. Subsection (1) is new and represents a departure from the Article on Secured Transactions (Article 9) as the subsection makes clear that whether a party to the lease agreement is in default is determined by this Article as well as the agreement. Sections 2A-508 and 2A-523. It further departs from Article 9 in recognizing the potential default of either party, a function of the bilateral nature of the obligations between the parties to the lease contract.

2. Subsection (2) is a version of the first sentence of Section 9-501(1), revised to reflect leasing terminology.

3. Subsection (3), an expansive version of the second sentence of Section 9-501(1), lists the procedures that may be followed by the party seeking enforcement; in effect, the scope of the procedures listed in subsection (3) is consistent with the scope of the procedures available to the foreclosing secured party.

4. Subsection (4) establishes that the parties' rights and remedies are cumulative. DeKoven, Leases of Equipment: Puritan Leasing Company v. August, A Dangerous Decision, 12 U.S. F.L.Rev. 257, 276-80 (1978). Cumulation, and largely unrestricted selection, of remedies is allowed in furtherance of the general policy of the Commercial Code, stated in Section 1-106, that remedies be liberally administered to put the aggrieved party in as good a position as if the other party had fully performed. Therefore, cumulation of, or selection among, remedies is available to the extent necessary to put the aggrieved party in as good a position as it would have been in had there been full performance. However, cumulation of, or selection among, remedies is not available to the extent that the cumulation or selection would put the aggrieved party in a better position than it would have been in had there been full performance by the other party.

5. Section 9-501(3), which, among other things, states that certain rules, to the extent they give rights to the debtor and impose duties on the secured party, may not be waived or varied, was not incorporated in this Article. Given the significance of freedom of contract in the development of the common law as it applies to bailments for hire and the lessee's lack of an equity of redemption, there was no reason to impose that restraint.

Cross References:

Sections 1-106, 2A-508, 2A-523, Article 9, especially Sections 9-501(1) and 9-501(3).

Definitional Cross References:

"Goods". Section 2A-103(1)(h).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).

§ 25-2A-502. Notice after default.

Except as otherwise provided in this Article or the lease agreement, the lessor or lessee in default under the lease contract is not entitled to notice of default or notice of enforcement from the other party to the lease agreement. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: None.

Purposes:

This section makes clear that absent agreement to the contrary or provision in this Article to the contrary, e.g., Section 2A-516(3)(a), the party in default is not entitled to notice of default or enforcement. While a review of Part 5 of Article 9 leads to the same conclusion with respect to giving notice of default to the debtor, it is never stated. Although Article 9 requires notice of disposition and strict foreclosure, the different scheme of lessors' and lessees' rights and remedies developed under the common law, and codified by this Article, generally does not require notice of enforcement; furthermore, such notice is not mandated by due process requirements. However, certain sections of this Article do require notice. E.g., Section 2A-517(2).

Cross References:

Sections 2A-516(3)(a), 2A-517(2), and Article 9, esp. Part 5.

Definitional Cross References:

"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notice". Section 1-201(25).
"Party". Section 1-201(29).

§ 25-2A-503. Modification or impairment of rights and remedies.

(1) Except as otherwise provided in this Article, the lease agreement may include rights and remedies for default in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article.

(2) Resort to a remedy provided under this Article or in the lease agreement is optional unless the remedy is expressly agreed to be exclusive. If circumstances cause an exclusive or limited remedy to fail of its essential purpose, or provision for an exclusive remedy is unconscionable, remedy may be had as provided in this Article.

(3) Consequential damages may be liquidated under G.S. 25-2A-504, or may otherwise be limited, altered, or excluded unless the limitation, alteration, or exclusion is unconscionable. Limitation, alteration, or exclusion of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation, alteration, or exclusion of damages where the loss is commercial is not prima facie unconscionable.

(4) Rights and remedies on default by the lessor or the lessee with respect to any obligation or promise collateral or ancillary to the lease contract are not impaired by this Article. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-719 and 2-701.

Changes: Rewritten to reflect lease terminology and to clarify the relationship between this section and Section 2A-504.

Purposes:

1. A significant purpose of this Part is to provide rights and remedies for those parties to a lease who fail to provide them by agreement or whose rights and remedies fail of their essential purpose or are unenforceable. However, it is important to note that this implies no restriction on freedom to contract. Sections 2A-103(4) and 1-102(3). Thus, subsection (1), a revised version of the provisions of Section 2-719(1), allows the parties to the lease agreement freedom to provide for rights and remedies in addition to or in substitution for those provided in this Article and to alter or limit the measure of damages recoverable under this Article. Except to the extent otherwise provided in this Article (e.g., Sections 2A-105, 106 and 108(1) and

(2)), this Part shall be construed neither to restrict the parties' ability to provide for rights and remedies or to limit or alter the measure of damages by agreement, nor to imply disapproval of rights and remedy schemes other than those set forth in this Part.

2. Subsection (2) makes explicit with respect to this Article what is implicit in Section 2-719 with respect to the Article on Sales (Article 2): if an exclusive remedy is held to be unconscionable, remedies under this Article are available. Section 2-719 official comment 1.

3. Subsection (3), a revision of Section 2-719(3), makes clear that consequential damages may also be liquidated. Section 2A-504(1).

4. Subsection (4) is a revision of the provisions of Section 2-701. This subsection leaves the treatment of default with respect to obligations or promises collateral or ancillary to the lease contract to other law. Sections 2A-103(4) and 1-103. An example of such an obligation would be that of the lessor to the secured creditor which has provided the funds to leverage the lessor's lease transaction; an example of such a promise would be that of the lessee, as seller, to the lessor, as buyer, in a sale-leaseback transaction.

Cross References:

Sections 1-102(3), 1-103, Article 2, especially Sections 2-701, 2-719, 2-719(1), 2-719(3), 2-719 official comment 1, and Sections 2A-103(4), 2A-105, 2A-106, 2A-108(1), 2A-108(2), and 2A-504.

Definitional Cross References:

"Agreed". Section 1-201(3).
"Consumer goods". Section 9-109(1).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Person". Section 1-201(30).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).

§ 25-2A-504. Liquidation of damages.

(1) Damages payable by either party for default, or any other act or omission, including indemnity for loss or diminution of anticipated tax benefits or loss or damage to lessor's residual interest, may be liquidated in the lease agreement but only at an amount or by a formula that is reasonable in light of the then-anticipated harm caused by the default or other act or omission.

(2) If the lease agreement provides for liquidation of damages, and such provision does not comply with subsection (1) of this section, or such provision is an exclusive or limited remedy that circumstances cause to fail of its essential purpose, remedy may be had as provided in this Article.

(3) If the lessor justifiably withholds or stops delivery of goods because of the lessee's default or insolvency (G.S. 25-2A-525 or G.S. 25-2A-526), the lessee is entitled to restitution of any amount by which the sum of his payments exceeds:

(a) the amount to which the lessor is entitled by virtue of terms liquidating the lessor's damages in accordance with subsection (1) of this section; or

(b) in the absence of those terms, twenty percent (20%) of the then-present value of the total rent the lessee was obligated to pay for the balance of the lease term, or, in the case of a consumer lease, the lesser of such amount or five hundred dollars ($500.00).

(4) A lessee's right to restitution under subsection (3) of this section is subject to offset to the extent the lessor establishes:

(a) a right to recover damages under the provisions of this Article other than subsection (1) of this section; and

(b) the amount or value of any benefits received by the lessee directly or indirectly by reason of the lease contract. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-718(1), (2), (3) and 2-719(2).

Changes: Substantially rewritten.

Purposes:

Many leasing transactions are predicated on the parties' ability to agree to an appropriate amount of damages or formula for damages in the event of default or other act or omission. The rule with respect to sales of goods (Section 2-718) may not be sufficiently flexible to accommodate this practice. Thus, consistent with the common law emphasis upon freedom to contract with respect to bailments for hire, this section has created a revised rule that allows greater flexibility with respect to leases of goods.

Subsection (1), a significantly modified version of the provisions of Section 2-718(1), provides for liquidation of damages in the lease agreement at an amount or by a formula. Section 2-718(1) does not by its express terms include liquidation by a formula; this change was compelled by modern leasing practice. Subsection (1), in a further expansion of Section 2-718(1), provides for liquidation of damages for default as well as any other act or omission.

A liquidated damages formula that is common in leasing practice provides that the sum of lease payments past due, accelerated future lease payments, and the lessor's estimated residual interest, less the net proceeds of disposition (whether by sale or re-lease) of the leased goods is the lessor's damages. Tax indemnities, costs, interest and attorney's fees are also added to determine the lessor's damages. Another common liquidated damages formula utilizes a periodic depreciation allocation as a credit to the aforesaid amount in mitigation of a lessor's damages. A third formula provides for a fixed number of periodic payments as a means of liquidating damages. Stipulated loss or stipulated damage schedules are also common. Whether these formulae are enforceable will be determined in the context of each case by applying a standard of reasonableness in light of the harm anticipated when the formula was agreed to. Whether the inclusion of these formulae will affect the classification of the transaction as a lease or a security interest is to be determined by the facts of each case. Section 1-201(37). E.g., In re Noack, 44 Bankr. 172, 174-75 (Bankr. E.D.Wis.1984).

This section does not incorporate two other tests that under sales law determine enforceability of liquidated damages, i.e., difficulties of proof of loss and inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. The ability to liquidate damages is critical to modern leasing practice; given the parties' freedom to contract at common law, the policy behind retaining these two additional requirements here was thought to be outweighed. Further, given the expansion of subsection (1) to enable the parties to liquidate the amount payable with respect to an indemnity for loss or diminution of anticipated tax benefits resulted in another change: the last sentence of Section 2-718(1), providing that a term fixing unreasonably large liquidated damages is void as a penalty, was also not incorporated. The impact of local, state and federal tax laws on a leasing transaction can result in an amount payable with respect to the tax indemnity many times greater than the original purchase price of the goods. By deleting the reference to unreasonably large liquidated damages the parties are free to negotiate a formula, restrained by the rule of reasonableness in this section. These changes should invite the parties to liquidate damages. Peters, Remedies for Breach of Contracts Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article Two, 73 Yale L.J. 199, 278 (1963).

Subsection (2), a revised version of Section 2-719(2), provides that if the liquidated damages provision is not enforceable or fails of its essential purpose, remedy may be had as provided in this Article.

Subsection (3)(b) of this section differs from subsection (2)(b) of Section 2-718; in the absence of a valid liquidated damages amount or formula the lessor is permitted to retain 20 percent of the present value of the total rent payable under the lease. The alternative limitation of $500 contained in Section 2-718 is deleted as unrealistically low with respect to a lease other than a consumer lease.

Cross References:

Sections 1-201(37), 2-718, 2-718(1), 2-718(2)(b) and 2-719(2).

Definitional Cross References:
"Consumer lease". Section 2A-103(1)(e).
"Delivery". Section 1-201(14).
"Goods". Section 2A-103(1)(h).
"Insolvent". Section 1-201(23).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Lessor's residual interest". Section 2A-103(1)(q).
"Party". Section 1-201(29).
"Present value". Section 2A-103(1)(u).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Term". Section 1-201(42).
"Value". Section 1-201(44).

§ 25-2A-505. Cancellation and termination and effect of cancellation, termination, rescission, or fraud on rights and remedies.

(1) On cancellation of the lease contract, all obligations that are still executory on both sides are discharged, but any right based on prior default or performance survives, and the cancelling party also retains any remedy for default of the whole lease contract or any unperformed balance.

(2) On termination of the lease contract, all obligations that are still executory on both sides are discharged, but any right based on prior default or performance survives.

(3) Unless the contrary intention clearly appears, expressions of "cancellation", "rescission", or the like of the lease contract may not be construed as a renunciation or discharge of any claim in damages for an antecedent default.

(4) Rights and remedies for material misrepresentation or fraud include all rights and remedies available under this Article for default.

(5) Neither rescission nor a claim for rescission of the lease contract nor rejection or return of the goods may bar or be deemed inconsistent with a claim for damages or other right or remedy. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-106(3) and (4), 2-720 and 2-721.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:
"Cancellation". Section 2A-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(*l*).
"Party". Section 1-201(29).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Termination". Section 2A-103(1)(z).

§ 25-2A-506. Statute of limitations.

(1) An action for default under a lease contract, including breach of warranty or indemnity, must be commenced within four years after the cause of action accrued. By the original lease contract the parties may reduce the period of limitation to not less than one year.

(2) A cause of action for default accrues when the act or omission on which the default or breach of warranty is based is or should have been discovered by the aggrieved party, or when the default occurs, whichever is later. A cause of action for indemnity accrues

when the act or omission on which the claim for indemnity is based is or should have been discovered by the indemnified party, whichever is later.

(3) If an action commenced within the time limited by subsection (1) of this section is so terminated as to leave available a remedy by another action for the same default or breach of warranty or indemnity, the other action may be commenced after the expiration of the time limited and within six months after the termination of the first action unless the termination resulted from voluntary discontinuance or from dismissal for failure or neglect to prosecute.

(4) This section does not alter the law on tolling of the statute of limitations nor does it apply to causes of action that have accrued before this Article becomes effective. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-725.

Changes: Substantially rewritten.

Purposes:

Subsection (1) does not incorporate the limitation found in Section 2-725(1) prohibiting the parties from extending the period of limitation. Breach of warranty and indemnity claims often arise in a lease transaction; with the passage of time such claims often diminish or are eliminated. To encourage the parties to commence litigation under these circumstances makes little sense.

Subsection (2) states two rules for determining when a cause of action accrues. With respect to default, the rule of Section 2-725(2) is not incorporated in favor of a more liberal rule of the later of the date when the default occurs or when the act or omission on which it is based is or should have been discovered. With respect to indemnity, a similarly liberal rule is adopted.

Cross References:

Sections 2-725(1) and 2-725(2).

Definitional Cross References:

"Action". Section 1-201(1).
"Aggrieved party". Section 1-201(2).
"Lease contract". Section 2A-103(1)(*l*).
"Party". Section 1-201(29).
"Remedy". Section 1-201(34).
"Termination". Section 2A-103(1)(z).

§ 25-2A-507. Proof of market rent: time and place.

(1) Damages based on market rent (G.S. 25-2A-519 or G.S. 25-2A-528) are determined according to the rent for the use of the goods concerned for a lease term identical to the remaining lease term of the original lease agreement and prevailing at the times specified in G.S. 25-2A-519 and G.S. 25-2A-528.

(2) If evidence of rent for the use of the goods concerned for a lease term identical to the remaining lease term of the original lease agreement and prevailing at the times or places described in this Article is not readily available, the rent prevailing within any reasonable time before or after the time described or at any other place or for a different lease term which in commercial judgment or under usage of trade would serve as a reasonable substitute for the one described may be used, making any proper allowance for the difference, including the cost of transporting the goods to or from the other place.

(3) Evidence of a relevant rent prevailing at a time or place or for a lease term other than the one described in this Article offered by one party is not admissible unless and until he has given the other party notice the court finds sufficient to prevent unfair surprise.

(4) If the prevailing rent or value of any goods regularly leased in any established market is in issue, reports in official publications or

trade journals or in newspapers or periodicals of general circulation published as the reports of that market are admissible in evidence. The circumstances of the preparation of the report may be shown to affect its weight but not its admissibility. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-723 and 2-724.

Changes: Revised to reflect leasing practices and terminology. Sections 2A-519 and 2A-528 specify the times as of which market rent is to be determined.

Definitional Cross References:
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Notice". Section 1-201(25).
"Party". Section 1-201(29).
"Reasonable time". Section 1-204(1) and (2).
"Usage of trade". Section 1-205.
"Value". Section 1-201(44).

B. Default by Lessor.

§ 25-2A-508. Lessee's remedies.

(1) If a lessor fails to deliver the goods in conformity to the lease contract (G.S. 25-2A-509) or repudiates the lease contract (G.S. 25-2A-402), or a lessee rightfully rejects the goods (G.S. 25-2A-509) or justifiably revokes acceptance of the goods (G.S. 25-2A-517), then with respect to any goods involved, and with respect to all of the goods if under an installment lease contract, the value of the whole lease contract is substantially impaired (G.S. 25-2A-510), the lessor is in default under the lease contract, and the lessee may:

(a) cancel the lease contract (G.S. 25-2A-505(1));
(b) recover so much of the rent and security as has been paid and is just under the circumstances;
(c) cover and recover damages as to all goods affected whether or not they have been identified to the lease contract (G.S. 25-2A-518 and G.S. 25-2A-520), or recover damages for nondelivery (G.S. 25-2A-519 and G.S. 25-2A-520);
(d) exercise any other rights or pursue any other remedies provided in the lease contract.

(2) If a lessor fails to deliver the goods in conformity to the lease contract or repudiates the lease contract, the lessee may also:

(a) if the goods have been identified, recover them (G.S. 25-2A-522); or
(b) in a proper case, obtain specific performance or replevy the goods (G.S. 25-2A-521).

(3) If a lessor is otherwise in default under a lease contract, the lessee may exercise the rights and pursue the remedies provided in the lease contract, which may include a right to cancel the lease, and in G.S. 25-2A-519(3).

(4) If a lessor has breached a warranty, whether express or implied, the lessee may recover damages (G.S. 25-2A-519(4)).

(5) On rightful rejection or justifiable revocation of acceptance, a lessee has a security interest in goods in the lessee's possession or control for any rent and security that has been paid and any expenses reasonably incurred in their inspection, receipt, transportation, and care and custody and may hold those goods and dispose of

them in good faith and in a commercially reasonable manner, subject to G.S. 25-2A-527(5). A lessee who has rightfully rejected the goods, or justifiably revoked acceptance of the goods, shall account to the lessor for any excess over the amount of the lessee's security interest.

(6) Subject to the provisions of G.S. 25-2A-407, a lessee, on notifying the lessor of the lessee's intention to do so, may deduct all or any part of the damages resulting from any default under the lease contract from any part of the rent still due under the same lease contract. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-711 and 2-717.

Changes: Substantially rewritten.

Purposes:

1. This section is an index to Sections 2A-509 through 522 which set out the lessee's rights and remedies after the lessor's default. The lessor and the lessee can agree to modify the rights and remedies available under this Article; they can, among other things, provide that for defaults other than those specified in subsection (1) the lessee can exercise the rights and remedies referred to in subsection (1); and they can create a new scheme of rights and remedies triggered by the occurrence of the default. Sections 2A-103(4) and 1-102(3).

2. Subsection (1), a substantially rewritten version of the provisions of Section 2-711(1), lists three cumulative remedies of the lessee where the lessor has failed to deliver conforming goods or has repudiated the contract, or the lessee has rightfully rejected or justifiably revoked. Sections 2A-501(2) and (4). Subsection (1) also allows the lessee to exercise any contractual remedy. This Article rejects any general doctrine of election of remedy. To determine if one remedy bars another in a particular case is a function of whether the lessee has been put in as good a position as if the lessor had fully performed the lease agreement. Use of multiple remedies is barred only if the effect is to put the lessee in a better position than it would have been in had the lessor fully performed under the lease. Sections 2A-103(4), 2A-501(4), and 1-106(1). Subsection 1(b), in recognition that no bright line can be created that would operate fairly in all installment-lease cases and in recognition of the fact that a lessee may be able to cancel the lease (revoke acceptance of the goods) after the goods have been in use for some period of time, does not require that all lease payments made by the lessee under the lease be returned upon cancellation. Rather, only such portion as is just of the rent and security payments made may be recovered. If a defect in the goods is discovered immediately upon tender to the lessee and the goods are rejected immediately, then the lessee should recover all payments made. If, however, for example, a 36-month equipment lease is terminated in the 12th month because the lessor has materially breached the contract by failing to perform its maintenance obligations, it may be just to return only a small part or none of the rental payments already made.

3. Subsection (2), a version of the provisions of Section 2-711(2) revised to reflect leasing terminology, lists two alternative remedies for the recovery of the goods by the lessee; however, each of these remedies is cumulative with respect to those listed in subsection (1).

4. Subsection (3) is new. It covers defaults which do not deprive the lessee of the goods and which are not so serious as to justify rejection or revocation of acceptance under subsection (1). It also covers defaults for which the lessee could have rejected or revoked acceptance of the goods but elects not to do so and retains the goods. In either case, a lessee which retains the goods is entitled to recover damages as stated in Section 2A-519(3). That measure of damages is "the loss resulting in the ordinary course of events from the lessor's default as determined in any manner that is reasonable together with incidental and consequential damages, less expenses saved in consequence of the lessor's breach."

5. Subsection (1)(d) and subsection (3) recognize that the lease agreement may provide rights and remedies in addition

to or different from those which Article 2A provides. In particular, subsection (3) provides that the lease agreement may give the remedy of cancellation of the lease for defaults by the lessor that would not otherwise be material defaults which would justify cancellation under subsection (1). If there is a right to cancel, there is, of course, a right to reject or revoke acceptance of the goods.

6. Subsection (4) is new and merely adds to the completeness of the index by including a reference to the lessee's recovery of damages upon the lessor's breach of warranty; such breach may not rise to the level of a default by the lessor justifying revocation of acceptance. If the lessee properly rejects or revokes acceptance of the goods because of a breach of warranty, the rights and remedies are those provided in subsection (1) rather than those in Section 2A-519(4).

7. Subsection (5), a revised version of the provisions of Section 2-711(3), recognizes, on rightful rejection or justifiable revocation, the lessee's security interest in goods in its possession and control. Section 9-113, which recognized security interests arising under the Article on Sales (Article 2), was amended with the adoption of this Article to reflect the security interests arising under this Article. Pursuant to Section 2A-511(4), a purchaser who purchases goods from the lessee in good faith takes free of any rights of the lessor, or in the case of a finance lease the supplier. Such goods, however, must have been rightfully rejected and disposed of pursuant to Section 2A-511 or 2A-512. However, Section 2A-517(5) provides that the lessee will have the same rights and duties with respect to goods where acceptance has been revoked as with respect to goods rejected. Thus, Section 2A-511(4) will apply to the lessee's disposition of such goods.

8. Pursuant to Section 2A-527(5), the lessee must account to the lessor for the excess proceeds of such disposition, after satisfaction of the claim secured by the lessee's security interest.

9. Subsection (6), a slightly revised version of the provisions of Section 2-717, sanctions a right of set-off by the lessee, subject to the rule of Section 2A-407 with respect to irrevocable promises in a finance lease that is not a consumer lease, and further subject to an enforceable "hell or high water" clause in the lease agreement. Section 2A-407 official comment. No attempt is made to state how the set-off should occur; this is to be determined by the facts of each case.

10. There is no special treatment of the finance lease in this section. Absent supplemental principles of law and equity to the contrary, in the case of most finance leases, following the lessee's acceptance of the goods the lessee will have no rights or remedies against the lessor, because the lessor's obligations to the lessee are minimal. Sections 2A-210 and 2A-211(1). Since the lessee will look to the supplier for performance, this is appropriate. Section 2A-209.

Cross References:

Sections 1-102(3), 1-103, 1-106(1), Article 2, especially Sections 2-711, 2-717 and Sections 2A-103(4), 2A-209, 2A-210, 2A-211(1), 2A-407, 2A-501(2), 2A-501(4), 2A-509 through 2A-522, 2A-511(3), 2A-517(5), 2A-527(5) and Section 9-113.

Definitional Cross References:

"Conforming". Section 2A-103(1)(d).

"Delivery". Section 1-201(14).

"Good faith". Sections 1-201(19) and 2-103(1)(b).

"Goods". Section 2A-103(1)(h).

"Installment lease contract". Section 2A-103(1)(i).

"Lease contract". Section 2A-103(1)(*l*).

"Lessee". Section 2A-103(1)(n).

"Lessor". Section 2A-103(1)(p).

"Notifies". Section 1-201(26).

"Receipt". Section 2-103(1)(c).

"Remedy". Section 1-201(34).

"Rights". Section 1-201(36).

"Security interest". Section 1-201(37).

"Value". Section 1-201(44).

§ 25-2A-509. Lessee's rights on improper delivery; rightful rejection.

(1) Subject to the provisions of G.S. 25-2A-510 on default in installment lease contracts, if the goods or the tender or delivery fail in any respect to conform to the lease contract, the lessee may reject or accept the goods or accept any commercial unit or units and reject the rest of the goods.

(2) Rejection of goods is ineffective unless it is within a reasonable time after tender or delivery of the goods and the lessee seasonably notifies the lessor. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-601 and 2-602(1).

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Commercial unit". Section 2A-103(1)(c).

"Conforming". Section 2A-103(1)(d).

"Delivery". Section 1-201(14).

"Goods". Section 2A-103(1)(h).

"Installment lease contract". Section 2A-103(1)(i).

"Lease contract". Section 2A-103(1)(*l*).

"Lessee". Section 2A-103(1)(n).

"Lessor". Section 2A-103(1)(p).

"Notifies". Section 1-201(26).

"Reasonable time". Section 1-204(1) and (2).

"Rights". Section 1-201(36).

"Seasonably". Section 1-204(3).

§ 25-2A-510. Installment lease contracts; rejection and default.

(1) Under an installment lease contract a lessee may reject any delivery that is nonconforming if the nonconformity substantially impairs the value of that delivery and cannot be cured or the nonconformity is a defect in the required documents; but if the nonconformity does not fall within subsection (2) of this section and the lessor or the supplier gives adequate assurance of its cure, the lessee must accept that delivery.

(2) Whenever nonconformity or default with respect to one or more deliveries substantially impairs the value of the installment lease contract as a whole, there is a default with respect to the whole. But, the aggrieved party reinstates the installment lease contract as a whole if the aggrieved party accepts a nonconforming delivery without seasonably notifying of cancellation or brings an action with respect only to past deliveries or demands performance as to future deliveries. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-612.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Action". Section 1-201(1).

"Aggrieved party". Section 1-201(2).

"Cancellation". Section 2A-103(1)(b).

"Conforming". Section 2A-103(1)(d).

"Delivery". Section 1-201(14).

"Installment lease contract". Section 2A-103(1)(i).

"Lessee". Section 2A-103(1)(n).

"Lessor". Section 2A-103(1)(p).

"Notifies". Section 1-201(26).

"Seasonably'". Section 1-204(3).

"Supplier". Section 2A-103(1)(x).

"Value". Section 1-201(44).

§ 25-2A-511. Merchant lessee's duties as to rightfully rejected goods.

(1) Subject to any security interest of a lessee (G.S. 25-2A-508(5)), if a lessor or a supplier has no agent or place of business at the market of rejection, a merchant lessee, after rejection of goods in his possession or control, shall follow any reasonable instructions received from the lessor or the supplier with respect to the goods. In the absence of those instructions, a merchant lessee shall make reasonable efforts to sell, lease, or otherwise dispose of the goods for the lessor's account if they threaten to decline in value speedily. Instructions are not reasonable if, on demand, indemnity for expenses is not forthcoming.

(2) If a merchant lessee (subsection (1) of this section) or any other lessee (G.S. 25-2A-512) disposes of goods, he is entitled to reimbursement either from the lessor or the supplier or out of the proceeds for reasonable expenses of caring for and disposing of the goods and, if the expenses include no disposition commission, to such commission as is usual in the trade, or if there is none, to a reasonable sum not exceeding ten percent (10%) of the gross proceeds.

(3) In complying with this section or G.S. 25-2A-512, the lessee is held only to good faith. Good faith conduct hereunder is neither acceptance or conversion nor the basis of an action for damages.

(4) A purchaser who purchases in good faith from a lessee pursuant to this section or G.S. 25-2A-512 takes the goods free of any rights of the lessor and the supplier even though the lessee fails to comply with one or more of the requirements of this Article. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-603 and 2-706(5).

Changes: Revised to reflect leasing practices and terminology. This section, by its terms, applies to merchants as well as others. Thus, in construing the section it is important to note that under this Act the term good faith is defined differently for merchants (Section 2-103(1)(b)) than for others (Section 1-201(19)). Section 2A-103(3) and (4).

Definitional Cross References:

"Action". Sections 1-201(1).

"Good faith". Sections 1-201(19) and 2-103(1)(b).

"Goods". Section 2A-103(1)(h).

"Lease". Section 2A-103(1)(j).

"Lessee". Section 2A-103(1)(n).

"Lessor". Section 2A-103(1)(p).

"Merchant lessee". Section 2A-103(1)(t).

"Purchaser". Section 1-201(33).

"Rights". Section 1-201(36).

"Security interest". Section 1-201(37).

"Supplier". Section 2A-103(1)(x).

"Value". Section 1-201(44).

§ 25-2A-512. Lessee's duties as to rightfully rejected goods.

(1) Except as otherwise provided with respect to goods that threaten to decline in value speedily (G.S. 25-2A-511) and subject to any security interest of a lessee (G.S. 25-2A-508(5)):

(a) the lessee, after rejection of goods in the lessee's possession, shall hold them with reasonable care at the lessor's or the supplier's disposition for a reasonable time after the lessee's seasonable notification of rejection;

(b) if the lessor or the supplier gives no instructions within a reasonable time after notification of rejection, the lessee may store the rejected goods for the lessor's or the supplier's account or ship them to the lessor or the supplier or dispose of them for the lessor's or the supplier's account with reimbursement in the manner provided in G.S. 25-2A-511; but

(c) the lessee has no further obligations with regard to goods rightfully rejected.

(2) Action by the lessee pursuant to subsection (1) of this section is not acceptance or conversion. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-602(2)(b) and (c) and 2-604.

Changes: Substantially rewritten.

Purposes:

The introduction to subsection (1) references goods that threaten to decline in value speedily and not perishables, the reference in Section 2-604, the statutory analogue. This is a change in style, not substance, as the first phrase includes the second. Subparagraphs (a) and (c) are revised versions of the provisions of Section 2-602(2)(b) and (c). Subparagraph (a) states the rule with respect to the lessee's treatment of goods in its possession following rejection; subparagraph (b) states the rule regarding such goods if the lessor or supplier then fails to give instructions to the lessee. If the lessee performs in a fashion consistent with subparagraphs (a) and (b), subparagraph (c) exonerates the lessee.

Cross References:

Sections 2-602(2)(b), 2-602(2)(c) and 2-604.

Definitional Cross References:

"Action". Section 1-201(1).
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notification". Section 1-201(26).
"Reasonable time". Section 1-204(1) and (2).
"Seasonably". Section 1-204(3).
"Security interest". Section 1-201(37).
"Supplier". Section 2A-103(1)(x).
"Value". Section 1-201(44).

§ 25-2A-513. Cure by lessor of improper tender or delivery; replacement.

(1) If any tender or delivery by the lessor or the supplier is rejected because nonconforming and the time for performance has not yet expired, the lessor or the supplier may seasonably notify the lessee of the lessor's or the supplier's intention to cure and may then make a conforming delivery within the time provided in the lease contract.

(2) If the lessee rejects a nonconforming tender that the lessor or the supplier had reasonable grounds to believe would be acceptable with or without money allowance, the lessor or the supplier may have a further reasonable time to substitute a conforming tender if he seasonably notifies the lessee. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-508.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).

"Lessor". Section 2A-103(1)(p).
"Money". Section 1-201(24).
"Notifies". Section 1-201(26).
"Reasonable time". Section 1-204(1) and (2).
"Seasonably". Section 1-204(3).
"Supplier". Section 2A-103(1)(x).

§ 25-2A-514. Waiver of lessee's objections.

(1) In rejecting goods, a lessee's failure to state a particular defect that is ascertainable by reasonable inspection precludes the lessee from relying on the defect to justify rejection or to establish default:

(a) if, stated seasonably, the lessor or the supplier could have cured it (G.S. 25-2A-513); or

(b) between merchants if the lessor or the supplier after rejection has made a request in writing for a full and final written statement of all defects on which the lessee proposes to rely.

(2) A lessee's failure to reserve rights when paying rent or other consideration against documents precludes recovery of the payment for defects apparent on the face of the documents. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-605.

Changes: Revised to reflect leasing practices and terminology.

Purposes:

The principles applicable to the commercial practice of payment against documents (subsection 2) are explained in official comment 4 to Section 2-605, the statutory analogue to this section.

Cross Reference:

Section 2-605 official comment 4.

Definitional Cross References:

"Between merchants". Section 2-104(3).
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Rights". Section 1-201(36).
"Seasonably". Section 1-204(3).
"Supplier". Section 2A-103(1)(x).
"Writing". Section 1-201(46).

§ 25-2A-515. Acceptance of goods.

(1) Acceptance of goods occurs after the lessee has had a reasonable opportunity to inspect the goods and:

(a) the lessee signifies or acts with respect to the goods in a manner that signifies to the lessor or the supplier that the goods are conforming or that the lessee will take or retain them in spite of their nonconformity; or

(b) the lessee fails to make an effective rejection of the goods (G.S. 25-2A-509(2)).

(2) Acceptance of a part of any commercial unit is acceptance of that entire unit. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-606.

Changes: The provisions of Section 2-606(1)(a) were substantially rewritten to provide that the lessee's conduct may signify acceptance. Further, the provisions of Section 2-606(1)(c) were not incorporated as irrelevant given the lessee's possession and use of the leased goods.

Cross References:
Sections 2-606(1)(a) and 2-606(1)(c).

Definitional Cross References:
"Commercial unit". Section 2A-103(1)(c).
"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Supplier". Section 2A-103(1)(x).

§ 25-2A-516. Effect of acceptance of goods; notice of default; burden of establishing default after acceptance; notice of claim or litigation to person answerable over.

(1) A lessee must pay rent for any goods accepted in accordance with the lease contract, with due allowance for goods rightfully rejected or not delivered.

(2) A lessee's acceptance of goods precludes rejection of the goods accepted. In the case of a finance lease, if made with knowledge of a nonconformity, acceptance cannot be revoked because of it. In any other case, if made with knowledge of a nonconformity, acceptance cannot be revoked because of it unless the acceptance was on the reasonable assumption that the nonconformity would be seasonably cured. Acceptance does not of itself impair any other remedy provided by this Article or the lease agreement for nonconformity.

(3) If a tender has been accepted:

(a) within a reasonable time after the lessee discovers or should have discovered any default, the lessee shall notify the lessor and the supplier, if any, or be barred from any remedy against the party not notified;

(b) except in the case of a consumer lease, within a reasonable time after the lessee receives notice of litigation for infringement or the like (G.S. 25-2A-211) the lessee shall notify the lessor or be barred from any remedy over for liability established by the litigation; and

(c) the burden is on the lessee to establish any default.

(4) If a lessee is sued for breach of a warranty or other obligation for which a lessor or a supplier is answerable over the following apply:

(a) the lessee may give the lessor or the supplier, or both, written notice of the litigation. If the notice states that the person notified may come in and defend and that if the person notified does not do so, that person will be bound in any action against that person by the lessee by any determination of fact common to the two litigations, then, unless the person notified after seasonable receipt of the notice does come in and defend, that person is so bound.

(b) the lessor or the supplier may demand in writing that the lessee turn over control of the litigation, including settlement, if the claim is one for infringement or the like (G.S. 25-2A-211) or else be barred from any remedy over. If the demand states that the lessor or the supplier agrees to bear all expense and to satisfy any adverse judgment, then, unless the lessee after seasonable receipt of the demand does turn over control, the lessee is so barred.

(5) Subsections (3) and (4) of this section apply to any obligation of a lessee to hold the lessor or the supplier harmless against infringement or the like (G.S. 25-2A-211). (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-607.

Changes: Substantially revised.

Purposes:

1. Subsection (2) creates a special rule for finance leases, precluding revocation if acceptance is made with knowledge of nonconformity with respect to the lease agreement, as opposed to the supply agreement; this is not inequitable as the lessee has a direct claim against the supplier. Section 2A-209(1). Revocation of acceptance of a finance lease is permitted if the lessee's acceptance was without discovery of the nonconformity (with respect to the lease agreement, not the supply agreement) and was reasonably induced by the lessor's assurances. Section 2A-517(1)(b). Absent exclusion or modification, the lessor under a finance lease makes certain warranties to the lessee. Sections 2A-210 and 2A-211(1). Revocation of acceptance is not prohibited even after the lessee's promise has become irrevocable and independent. Section 2A-407 official comment. Where the finance lease creates a security interest, the rule may be to the contrary. General Elec. Credit Corp. of Tennessee v. Ger-Beck Mach. Co., 806 F.2d 1207 (3rd Cir. 1986).

2. Subsection (3)(a) requires the lessee to give notice of default, within a reasonable time after the lessee discovered or should have discovered the default. In a finance lease, notice may be given either to the supplier, the lessor, or both, but remedy is barred against the party not notified. In a finance lease, the lessor is usually not liable for defects in the goods and the essential notice is to the supplier. While notice to the finance lessor will often not give any additional rights to the lessee, it would be good practice to give the notice since the finance lessor has an interest in the goods. Subsection (3)(a) does not use the term finance lease, but the definition of supplier is a person from whom a lessor buys or leases goods to be leased under a finance lease. Section 2A-103(1)(x). Therefore, there can be a "supplier" only in a finance lease. Subsection (4) applies similar notice rules as to lessors and suppliers if a lessee is sued for a breach of warranty or other obligation for which a lessor or supplier is answerable over.

3. Subsection (3)(b) requires the lessee to give the lessor notice of litigation for infringement or the like. There is an exception created in the case of a consumer lease. While such an exception was considered for a finance lease, it was not created because it was not necessary — the lessor in a finance lease does not give a warranty against infringement. Section 2A-211(2). Even though not required under subsection (3)(b), the lessee who takes under a finance lease should consider giving notice of litigation for infringement or the like to the supplier, because the lessee obtains the benefit of the suppliers' promises subject to the suppliers' defenses or claims. Sections 2A-209(1) and 2-607(3)(b).

Cross References:

Sections 2-607(3)(b), 2A-103(1)(x), 2A-209(1), 2A-210, 2A-211(1), 2A-211(2), 2A-407 official comment and 2A-517(1)(b).

Definitional Cross References:

"Action". Section 1-201(1).
"Agreement". Section 1-201(3).
"Burden of establishing". Section 1-201(8).
"Conforming". Section 2A-103(1)(d).
"Consumer lease". Section 2A-103(1)(e).
"Delivery". Section 1-201(14).
"Discover". Section 1-201(25).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Knowledge". Section 1-201(25).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notice". Section 1-201(25).
"Notifies". Section 1-201(26).
"Person". Section 1-201(30).
"Reasonable time". Section 1-204(1) and (2).
"Receipt". Section 2-103(1)(c).
"Remedy". Section 1-201(34).
"Seasonably". Section 1-204(3).
"Supplier". Section 2A-103(1)(x).
"Written". Section 1-201(46).

§ 25-2A-517. Revocation of acceptance of goods.

(1) A lessee may revoke acceptance of a lot or commercial unit whose nonconformity substantially impairs its value to the lessee if the lessee has accepted it:

(a) except in the case of a finance lease, on the reasonable assumption that its nonconformity would be cured and it has not been seasonably cured; or

(b) without discovery of the nonconformity if the lessee's acceptance was reasonably induced either by the lessor's assurances or, except in the case of a finance lease, by the difficulty of discovery before acceptance.

(2) Except in the case of a finance lease that is not a consumer lease, a lessee may revoke acceptance of a lot or commercial unit if the lessor defaults under the lease contract and the default substantially impairs the value of that lot or commercial unit to the lessee.

(3) If the lease agreement so provides, the lessee may revoke acceptance of a lot or commercial unit because of other defaults by the lessor.

(4) Revocation of acceptance must occur within a reasonable time after the lessee discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by the nonconformity. Revocation is not effective until the lessee notifies the lessor.

(5) A lessee who so revokes has the same rights and duties with regard to the goods involved as if the lessee had rejected them. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-608.

Changes: Revised to reflect leasing practices and terminology. Note that in the case of a finance lease the lessee retains a limited right to revoke acceptance. Sections 2A-517(1)(b) and 2A-516 official comment. New subsections (2) and (3) added.

Purposes:

1. The section states the situations under which the lessee may return the goods to the lessor and cancel the lease. Subsection (2) recognizes that the lessor may have continuing obligations under the lease and that a default as to those obligations may be sufficiently material to justify revocation of acceptance of the leased items and cancellation of the lease by the lessee. For example, a failure by the lessor to fulfill its obligation to maintain leased equipment or to supply other goods which are necessary for the operation of the leased equipment may justify revocation of acceptance and cancellation of the lease.

2. Subsection (3) specifically provides that the lease agreement may provide that the lessee can revoke acceptance for defaults by the lessor which in the absence of such an agreement might not be considered sufficiently serious to justify revocation. That is, the parties are free to contract on the question of what defaults are so material that the lessee can cancel the lease.

Cross References:

Section 2A-516 official comment.

Definitional Cross References:

"Commercial unit". Section 2A-103(1)(c).
"Conforming". Section 2A-103(1)(d).
"Discover". Section 1-201(25).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Lot". Section 2A-103(1)(s).
"Notifies". Section 1-201(26).
"Reasonable time". Section 1-204(1) and (2).
"Rights". Section 1-201(36).
"Seasonably". Section 1-204(3).
"Value". Section 1-201(44).

§ 25-2A-518. Cover; substitute goods.

(1) After a default by a lessor under the lease contract of the type described in G.S. 25-2A-508(1), or, if agreed, after other default by the lessor, the lessee may cover by making any purchase or lease of or contract to purchase or lease goods in substitution for those due from the lessor.

(2) Except as otherwise provided with respect to damages liquidated in the lease agreement (G.S. 25-2A-504) or otherwise determined pursuant to agreement of the parties (G.S. 25-1-102(3) and G.S. 25-2A-503), if a lessee's cover is by a lease agreement substantially similar to the original lease agreement and the new lease agreement is made in good faith and in a commercially reasonable manner, the lessee may recover from the lessor as damages (i) the present value, as of the date of the commencement of the term of the new lease agreement, of the rent under the new lease agreement applicable to that period of the new lease term which is comparable to the then remaining term of the original lease agreement minus the present value as of the same date of the total rent for the then remaining lease term of the original lease agreement, and (ii) any incidental or consequential damages, less expenses saved in consequence of the lessor's default.

(3) If a lessee's cover is by lease agreement that for any reason does not qualify for treatment under subsection (2) of this section, or is by purchase or otherwise, the lessee may recover from the lessor as if the lessee had elected not to cover and G.S. 25-2A-519 governs. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-712.

Changes: Substantially revised.

Purposes:

1. Subsection (1) allows the lessee to take action to fix its damages after default by the lessor. Such action may consist of the lease of goods. The decision to cover is a function of commercial judgment, not a statutory mandate replete with sanctions for failure to comply. Cf. Section 9-507.

2. Subsection (2) states a rule for determining the amount of lessee's damages provided that there is no agreement to the contrary. The lessee's damages will be established using the new lease agreement as a measure if the following three criteria are met: (i) the lessee's cover is by lease agreement, (ii) the lease agreement is substantially similar to the original lease agreement, and (iii) such cover was effected in good faith, and in a commercially reasonable manner. Thus, the lessee will be entitled to recover from the lessor the present value, as of the date of commencement of the term of the new lease agreement, of the rent under the new lease agreement applicable to that period which is comparable to the then remaining term of the original lease agreement less the present value of the rent reserved for the remaining term under the original lease, together with incidental or consequential damages less expenses saved in consequence of the lessor's default. Consequential damages may include loss suffered by the lessee because of deprivation of the use of the goods during the period between the default and the acquisition of the goods under the new lease agreement. If the lessee's cover does not satisfy the criteria of subsection (2), Section 2A-519 governs.

3. Two of the three criteria to be met by the lessee are familiar, but the concept of the new lease agreement being substantially similar to the original lease agreement is not. Given the many variables facing a party who intends to lease goods and the rapidity of change in the market place, the policy decision was made not to draft with specificity. It was thought unwise to seek to establish certainty at the cost of fairness. Thus,

the decision of whether the new lease agreement is substantially similar to the original will be determined case by case.

4. While the section does not draw a bright line, it is possible to describe some of the factors that should be considered in finding that a new lease agreement is substantially similar to the original. First, the goods subject to the new lease agreement should be examined. For example, in a lease of computer equipment the new lease might be for more modern equipment. However, it may be that at the time of the lessor's breach it was not possible to obtain the same type of goods in the market place. Because the lessee's remedy under Section 2A-519 is intended to place the lessee in essentially the same position as if he had covered, if goods similar to those to have been delivered under the original lease are not available, then the computer equipment in this hypothetical should qualify as a commercially reasonable substitute. See Section 2-712(1).

5. Second, the various elements of the new lease agreement should also be examined. Those elements include the presence or absence of options to purchase or release; the lessor's representations, warranties and covenants to the lessee, as well as those to be provided by the lessee to the lessor; and the services, if any, to be provided by the lessor or by the lessee. All of these factors allocate cost and risk between the lessor and the lessee and thus affect the amount of rent to be paid. If the differences between the original lease and the new lease can be easily valued, it would be appropriate for a court to adjust the difference in rental to take account of the difference between the two leases, find that the new lease is substantially similar to the old lease, and award cover damages under this section. If, for example, the new lease requires the lessor to insure the goods in the hands of the lessee, while the original lease required the lessee to insure, the usual cost of such insurance could be deducted from the rent due under the new lease before determining the difference in rental between the two leases.

6. Having examined the goods and the agreement, the test to be applied is whether, in light of these comparisons, the new lease agreement is substantially similar to the original lease agreement. These findings should not be made with scientific precision, as they are a function of economics, nor should they be made independently with respect to the goods and each element of the agreement, as it is important that a sense of commercial judgment pervade the finding. To establish the new lease as a proper measure of damage under subsection (2), these factors, taken as a whole, must result in a finding that the new lease agreement is substantially similar to the original.

7. A new lease can be substantially similar to the original lease even though its term extends beyond the remaining term of the original lease, so long as both (a) the lease terms are commercially comparable (e.g., it is highly unlikely that a one-month rental and a five-year lease would reflect similar commercial realities), and (b) the court can fairly apportion a part of the rental payments under the new lease to that part of the term of the new lease which is comparable to the remaining lease term under the original lease. Also, the lease term of the new lease may be comparable to the term of the original lease even though the beginning and ending dates of the two leases are not the same. For example, a two-month lease of agricultural equipment for the months of August and September may be comparable to a two-month lease running from the 15th of August to the 15th of October if in the particular location two-month leases beginning on August 15th are basically interchangeable with two-month leases beginning August 1st. Similarly, the term of a one-year truck lease beginning on the 15th of January may be comparable to the term of a one-year truck lease beginning January 2d. If the lease terms are found to be comparable, the court may base cover damages on the entire difference between the costs under the two leases.

Cross References:

Sections 2-712(1), 2A-519 and 9-507.

Definitional Cross References:

"Agreement". Section 1-201(3).
"Contract". Section 1-201(11).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).

"Party". Section 1-201(29).
"Present value". Section 2A-103(1)(u).
"Purchase". Section 2A-103(1)(v).

§ 25-2A-519. Lessee's damages for nondelivery, repudiation, default, and breach of warranty in regard to accepted goods.

(1) Except as otherwise provided with respect to damages liquidated in the lease agreement (G.S. 25-2A-504) or otherwise determined pursuant to agreement of the parties (G.S. 25-1-102(3) and G.S. 25-2A-503), if a lessee elects not to cover or a lessee elects to cover and the cover is by lease agreement that for any reason does not qualify for treatment under G.S. 25-2A-518(2), or is by purchase or otherwise, the measure of damages for nondelivery or repudiation by the lessor or for rejection or revocation of acceptance by the lessee is the present value, as of the date of the default, of the then market rent minus the present value as of the same date of the original rent, computed for the remaining lease term of the original lease agreement, together with incidental and consequential damages, less expenses saved in consequence of the lessor's default.

(2) Market rent is to be determined as of the place for tender or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival.

(3) Except as otherwise agreed, if the lessee has accepted goods and given notification (G.S. 25-2A-516(3)), the measure of damages for nonconforming tender or delivery or other default by a lessor is the loss resulting in the ordinary course of events from the lessor's default as determined in any manner that is reasonable together with incidental and consequential damages, less expenses saved in consequence of the lessor's default.

(4) Except as otherwise agreed, the measure of damages for breach of warranty is the present value at the time and place of acceptance of the difference between the value of the use of the goods accepted and the value if they had been as warranted for the lease term, unless special circumstances show proximate damages of a different amount, together with incidental and consequential damages, less expenses saved in consequence of the lessor's default or breach of warranty. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-713 and 2-714.

Changes: Substantially revised.

Purposes:

1. Subsection (1), a revised version of the provisions of Section 2-713(1), states the basic rule governing the measure of lessee's damages for non-delivery or repudiation by the lessor or for rightful rejection or revocation of acceptance by the lessee. This measure will apply, absent agreement to the contrary, if the lessee does not cover or if the cover does not qualify under Section 2A-518. There is no sanction for cover that does not qualify.

2. The measure of damage is the present value, as of the date of default, of the market rent for the remaining term of the lease less the present value of the original rent for the remaining term of the lease, plus incidental and consequential damages less expenses saved in consequence of the default. Note that the reference in Section 2A-519(1) is to the date of default not to the date of an event of default. An event of default under a lease agreement be-

comes a default under a lease agreement only after the expiration of any relevant period of grace and compliance with any notice requirements under this Article and the lease agreement. American Bar Foundation, Commentaries on Indentures, § 5-1, at 216-217 (1971). Section 2A-501(1). This conclusion is also a function of whether, as a matter of fact or law, the event of default has been waived, suspended or cured. Sections 2A-103(4) and 1-103.

3. Subsection (2), a revised version of the provisions of Section 2-713(2), states the rule with respect to determining market rent.

4. Subsection (3), a revised version of the provisions of Section 2-714(1) and (3), states the measure of damages where goods have been accepted and acceptance is not revoked. The subsection applies both to defaults which occur at the inception of the lease and to defaults which occur subsequently, such as failure to comply with an obligation to maintain the leased goods. The measure in essence is the loss, in the ordinary course of events, flowing from the default.

5. Subsection (4), a revised version of the provisions of Section 2-714(2), states the measure of damages for breach of warranty. The measure in essence is the present value of the difference between the value of the goods accepted and of the goods if they had been as warranted.

6. Subsections (1), (3) and (4) specifically state that the parties may by contract vary the damages rules stated in those subsections.

Cross References:
Sections 2-713(1), 2-713(2), 2-714 and Section 2A-518.

Definitional Cross References:
"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notification". Section 1-201(26).
"Present value". Section 2A-103(1)(u).
"Value". Section 1-201(44).

§ 25-2A-520. Lessee's incidental and consequential damages.

(1) Incidental damages resulting from a lessor's default include expenses reasonably incurred in inspection, receipt, transportation, and care and custody of goods rightfully rejected or goods the acceptance of which is justifiably revoked, any commercially reasonable charges, expenses or commissions in connection with effecting cover, and any other reasonable expense incident to the default.

(2) Consequential damages resulting from a lessor's default include:

(a) any loss resulting from general or particular requirements and needs of which the lessor at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and

(b) injury to person or property proximately resulting from any breach of warranty. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-715.

Changes: Revised to reflect leasing terminology and practices.

Purposes:
Subsection (1), a revised version of the provisions of Section 2-715(1), lists some examples of incidental damages resulting from a lessor's default; the list is not exhaustive. Subsection (1) makes clear that it applies not only to rightful rejection, but also to justifiable revocation.

Subsection (2), a revised version of the provisions of Section 2-715(2), lists some examples of consequential damages resulting from a lessor's default; the list is not exhaustive.

Cross References:
Section 2-715.

Definitional Cross References:
"Goods". Section 2A-103(1)(h).
"Knows". Section 1-201(25).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Person". Section 1-201(30).
"Receipt". Section 2-103(1)(c).

§ 25-2A-521. Lessee's right to specific performance or replevin.

(1) Specific performance may be decreed if the goods are unique or in other proper circumstances.

(2) A decree for specific performance may include any terms and conditions as to payment of the rent, damages, or other relief that the court deems just.

(3) A lessee has a right of replevin, detinue, sequestration, claim and delivery, or the like for goods identified to the lease contract if after reasonable effort the lessee is unable to effect recovery for those goods or the circumstances reasonably indicate that the effort will be unavailing. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-716.

Changes: Revised to reflect leasing practices and terminology, and to expand the reference to the right of replevin in subsection (3) to include other similar rights of the lessee.

Definitional Cross References:
"Delivery". Section 1-201(14).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Rights". Section 1-201(36).
"Term". Section 1-201(42).

§ 25-2A-522. Lessee's right to goods on lessor's insolvency.

(1) Subject to subsection (2) of this section and even though the goods have not been shipped, a lessee who has paid a part or all of the rent and security for goods identified to a lease contract (G.S. 25-2A-217) on making and keeping good a tender of any unpaid portion of the rent and security due under the lease contract may recover the goods identified from the lessor if the lessor becomes insolvent within 10 days after receipt of the first installment of rent and security.

(2) A lessee acquires the right to recover goods identified to a lease contract only if they conform to the lease contract. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-502.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:
"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).
"Insolvent". Section 1-201(23).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Receipt". Section 2-103(1)(c).
"Rights". Section 1-201(36).

C. Default by Lessee

§ 25-2A-523. Lessor's remedies.

(1) If a lessee wrongfully rejects or revokes acceptance of goods or fails to make a payment when due or repudiates with respect to a part or the whole, then, with respect to any goods involved, and with respect to all of the goods if under an installment lease contract the value of the whole lease contract is substantially impaired (G.S. 25-2A-510), the lessee is in default under the lease contract and the lessor may:

(a) cancel the lease contract (G.S. 25-2A-505(1));
(b) proceed respecting goods not identified to the lease contract (G.S. 25-2A-524);
(c) withhold delivery of the goods and take possession of goods previously delivered (G.S. 25-2A-525);
(d) stop delivery of the goods by any bailee (G.S. 25-2A-526);
(e) dispose of the goods and recover damages (G.S. 25-2A-527), or retain the goods and recover damages (G.S. 25-2A-528), or in a proper case recover rent (G.S. 25-2A-529);
(f) exercise any other rights or pursue any other remedies provided in the lease contract.

(2) If a lessor does not fully exercise a right or obtain a remedy to which the lessor is entitled under subsection (1) of this section, the lessor may recover the loss resulting in the ordinary course of events from the lessee's default as determined in any reasonable manner, together with incidental damages, less expenses saved in consequence of the lessee's default.

(3) If a lessee is otherwise in default under a lease contract, the lessor may exercise the rights and pursue the remedies provided in the lease contract, which may include a right to cancel the lease. In addition, unless otherwise provided in the lease contract:

(a) if the default substantially impairs the value of the lease contract to the lessor, the lessor may exercise the rights and pursue the remedies provided in subsections (1) or (2) of this section; or
(b) if the default does not substantially impair the value of the lease contract to the lessor, the lessor may recover as provided in subsection (2) of this section. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-703.

Changes: Substantially revised.

Purposes:

1. Subsection (1) is an index to Sections 2A-524 through 2A-531 and states that the remedies provided in those sections are available for the defaults referred to in subsection (1): wrongful rejection or revocation of acceptance, failure to make a payment when due, or repudiation. In addition, remedies provided in the lease contract are available. Subsection (2) sets out a remedy if the lessor does not pursue to completion a right or actually obtain a remedy available under subsection (1), and subsection (3) sets out statutory remedies for defaults not specifically referred to in subsection (1). Subsection (3) provides that, if any default by the lessee other than those specifically referred to in subsection (1) is material, the lessor can exercise the remedies provided in subsection (1) or (2); otherwise the available remedy is as provided in subsection (3). A lessor who has brought an action seeking or has nonjudicially pursued one or

more of the remedies available under subsection (1) may amend so as to claim or may nonjudicially pursue a remedy under subsection (2) unless the right or remedy first chosen has been pursued to an extent actually inconsistent with the new course of action. The intent of the provision is to reject the doctrine of election of remedies and to permit an alteration of course by the lessor unless such alteration would actually have an effect on the lessee that would be unreasonable under the circumstances. Further, the lessor may pursue remedies under both subsections (1) and (2) unless doing so would put the lessor in a better position than it would have been in had the lessee fully performed.

2. The lessor and the lessee can agree to modify the rights and remedies available under the Article; they can, among other things, provide that for defaults other than those specified in subsection (1) the lessor can exercise the rights and remedies referred to in subsection (1), whether or not the default would otherwise be held to substantially impair the value of the lease contract to the lessor; they can also create a new scheme of rights and remedies triggered by the occurrence of the default. Sections 2A-103(4) and 1-102(3).

3. Subsection (1), a substantially rewritten version of Section 2-703, lists various cumulative remedies of the lessor where the lessee wrongfully rejects or revokes acceptance, fails to make a payment when due, or repudiates. Section 2A-501(2) and (4). The subsection also allows the lessor to exercise any contractual remedy.

4. This Article rejects any general doctrine of election of remedy. Whether, in a particular case, one remedy bars another, is a function of whether lessor has been put in as good a position as if the lessee had fully performed the lease contract. Multiple remedies are barred only if the effect is to put the lessor in a better position than it would have been in had the lessee fully performed under the lease. Sections 2A-103(4), 2A-501(4), and 1-106(1).

5. Hypothetical: To better understand the application of subparagraphs (a) through (e), it is useful to review a hypothetical. Assume that A is a merchant in the business of selling and leasing new bicycles of various types. B is about to engage in the business of subleasing bicycles to summer residents of and visitors to an island resort. A, as lessor, has agreed to lease 60 bicycles to B. While there is one master lease, deliveries and terms are staggered. 20 bicycles are to be delivered by A to B's island location on June 1; the term of the lease of these bicycles is four months. 20 bicycles are to be delivered by A to B's island location on July 1; the term of the lease of these bicycles is three months. Finally, 20 bicycles are to be delivered by A to B's island location on August 1; the term of the lease of these bicycles is two months. B is obligated to pay rent to A on the 15th day of each month during the term for the lease. Rent is $50 per month, per bicycle. B has no option to purchase or release and must return the bicycles to A at the end of the term, in good condition, reasonable wear and tear excepted. Since the retail price of each bicycle is $400 and bicycles used in the retail rental business have a useful economic life of 36 months, this transaction creates a lease. Sections 2A-103(1)(j) and 1-201(37).

6. A's current inventory of bicycles is not large. Thus, upon signing the lease with B in February, A agreed to purchase 60 new bicycles from A's principal manufacturer, with special instructions to drop ship the bicycles to B's island location in accordance with the delivery schedule set forth in the lease.

7. The first shipment of 20 bicycles was received by B on May 21. B inspected the bicycles, accepted the same as conforming to the lease and signed a receipt of delivery and acceptance. However, due to poor weather that summer, business was terrible and B was unable to pay the rent due on June 15. Pursuant to the lease A sent B notice of default and proceeded to enforce his rights and remedies against B.

8. A's counsel first advised A that under Section 2A-510(2) and the terms of the lease B's failure to pay was a default with respect to the whole. Thus, to minimize A's continued exposure, A was advised to take possession of the bicycles. If A had possession of the goods A could refuse to deliver. Section 2A-525(1). However, the facts here are different. With respect to the bicycles in B's possession, A has the right to take possession of the bicycles, without breach of the peace. Section 2A-525(2). If B refuses to allow A access to the bicycles, A can proceed by action, including replevin or injunctive relief.

9. With respect to the 40 bicycles that have not been delivered, this Article

provides various alternatives. First, assume that 20 of the remaining 40 bicycles have been manufactured and delivered by the manufacturer to a carrier for shipment to B. Given the size of the shipment, the carrier was using a small truck for the delivery and the truck had not yet reached the island ferry when the manufacturer (at the request of A) instructed the carrier to divert the shipment to A's place of business. A's right to stop delivery is recognized under these circumstances. Section 2A-526(1). Second, assume that the 20 remaining bicycles were in the process of manufacture when B defaulted. A retains the right (as between A as lessor and B as lessee) to exercise reasonable commercial judgment whether to complete manufacture or to dispose of the unfinished goods for scrap. Since A is not the manufacturer and A has a binding contract to buy the bicycles, A elected to allow the manufacturer to complete the manufacture of the bicycles, but instructed the manufacturer to deliver the completed bicycles to A's place of business. Section 2A-524(2).

10. Thus, so far A has elected to exercise the remedies referred to in subparagraphs (b) through (d) in subsection (1). None of these remedies bars any of the others because A's election and enforcement merely resulted in A's possession of the bicycles. Had B performed A would have recovered possession of the bicycles. Thus A is in the process of obtaining the benefit of his bargain. Note that A could exercise any other rights or pursue any other remedies provided in the lease contract (Section 2A-523(1)(f)), or elect to recover his loss due to the lessee's default under Section 2A-523(2).

11. A's counsel next would determine what action, if any, should be taken with respect to the goods. As stated in subparagraph (e) and as discussed fully in Section 2A-527(1) the lessor may, but has no obligation to, dispose of the goods by a substantially similar lease (indeed, the lessor has no obligation whatsoever to dispose of the goods at all) and recover damages based on that action, but lessor will not be able to recover damages which put it in a better position than performance would have done, nor will it be able to recover damages for losses which it could have reasonably avoided. In this case, since A is in the business of leasing and selling bicycles, A will probably inventory the 60 bicycles for its retail trade.

12. A's counsel then will determine which of the various means of ascertaining A's damages against B are available. Subparagraph (e) catalogues each relevant section. First, under Section 2A-527(2) the amount of A's claim is computed by comparing the original lease between A and B with any subsequent lease of the bicycles but only if the subsequent lease is substantially similar to the original lease contract. While the section does not define this term, the official comment does establish some parameters. If, however, A elects to lease the bicycles to his retail trade, it is unlikely that the resulting lease will be substantially similar to the original, as leases to retail customers are considerably different from leases to wholesale customers like B. If, however, the leases were substantially similar, the damage claim is for accrued and unpaid rent to the beginning of the new lease, plus the present value as of the same date, of the rent reserved under the original lease for the balance of its term less the present value as of the same date of the rent reserved under the replacement lease for a term comparable to the balance of the term of the original lease, together with incidental damages less expenses saved in consequence of the lessee's default.

13. If the new lease is not substantially similar or if A elects to sell the bicycles or to hold the bicycles, damages are computed under Section 2A-528 or 2A-529.

14. If A elects to pursue his claim under Section 2A-528(1) the damage rule is the same as that stated in Section 2A-527(2) except that damages are measured from default if the lessee never took possession of the goods or from the time when the lessor did or could have regained possession and that the standard of comparison is not the rent reserved under a substantially similar lease entered into by the lessor but a market rent, as defined in Section 2A-507. Further, if the facts of this hypothetical were more elaborate A may be able to establish that the measure of damage under subsection (1) is inadequate to put him in the same position that B's performance would have, in which case A can claim the present value of his lost profits.

15. Yet another alternative for computing A's damage claim against B which will be available in some situations is recovery of the present value, as

of entry of judgment, of the rent for the then remaining lease term under Section 2A-529. However, this formulation is not available if the goods have been repossessed or tendered back to A. For the 20 bicycles repossessed and the remaining 40 bicycles, A will be able to recover the present value of the rent only if A is unable to dispose of them, or circumstances indicate the effort will be unavailing. If A has prevailed in an action for the rent, at any time up to collection of a judgment by A against B, A might dispose of the bicycles. In such case A's claim for damages against B is governed by Section 2A-527 or 2A-528. Section 2A-529(3). The resulting recalculation of claim should reduce the amount recoverable by A against B and the lessor is required to cause an appropriate credit to be entered against the earlier judgment. However, the nature of the post-judgment proceedings to resolve the issue, and the sanctions for a failure to comply, if any, will be determined by other law.

16. Finally, if the lease agreement had so provided pursuant to subparagraph (f), A's claim against B would not be determined under any of these statutory formulae, but pursuant to a liquidated damages clause. Section 2A-504(1).

17. These various methods of computing A's damage claim against B are alternatives subject to Section 2A-501(4). However, the pursuit of any one of these alternatives is not a bar to, nor has it been barred by, A's earlier action to obtain possession of the 60 bicycles. These formulae, which vary as a function of an overt or implied mitigation of damage theory, focus on allowing A a recovery of the benefit of his bargain with B. Had B performed, A would have received the rent as well as the return of the 60 bicycles at the end of the term.

18. Finally, A's counsel should also advise A of his right to cancel the lease contract under subparagraph (a). Section 2A-505(1). Cancellation will discharge all existing obligations but preserve A's rights and remedies.

19. Subsection (2) recognizes that a lessor who is entitled to exercise the rights or to obtain a remedy granted by subsection (1) may choose not to do so. In such cases, the lessor can recover damages as provided in subsection (2). For example, for non-payment of rent, the lessor may decide not to take possession of the goods and cancel the lease, but rather to merely sue for the unpaid rent as it comes due plus lost interest or other damages "determined in any reasonable manner." Subsection (2) also negates any loss of alternative rights and remedies by reason of having invoked or commenced the exercise or pursuit of any one or more rights or remedies.

20. Subsection (3) allows the lessor access to a remedy scheme provided in this Article as well as that contained in the lease contract if the lessee is in default for reasons other than those stated in subsection (1). Note that the reference to this Article includes supplementary principles of law and equity, e.g., fraud, misrepresentation and duress. Sections 2A-103(4) and 1-103.

21. There is no special treatment of the finance lease in this section. Absent supplementary principles of law to the contrary, in most cases the supplier will have no rights or remedies against the defaulting lessee. Section 2A-209(2)(ii). Given that the supplier will look to the lessor for payment, this is appropriate. However, there is a specific exception to this rule with respect to the right to identify goods to the lease contract. Section 2A-524(2). The parties are free to create a different result in a particular case. Sections 2A-103(4) and 1-102(3).

Cross References:

Sections 1-102(3), 1-103, 1-106(1), 1-201(37), 2-703, 2A-103(1)(j), 2A-103(4), 2A-209(2)(ii), 2A-501(4), 2A-504(1), 2A-505(1), 2A-507, 2A-510(2), 2A-524 through 2A-531, 2A-524(2), 2A-525(1), 2A-525(2), 2A-526(1), 2A-527(1), 2A-527(2), 2A-528(1) and 2A-529(3).

Definitional Cross References:

"Delivery". Section 1-201(14).
"Goods". Section 2A-103(1)(h).
"Installment lease contract". Section 2A-103(1)(i).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Value". Section 1-201(44).

§ 25-2A-524. Lessor's right to identify goods to lease contract.

(1) After default by the lessee under the lease contract of the type described in G.S. 25-2A-523(1) or G.S. 25-2A-523(3)(a) or, if agreed, after other default by the lessee, the lessor may:

(a) identify to the lease contract conforming goods not already identified if at the time the lessor learned of the default they were in the lessor's or the supplier's possession or control; and

(b) dispose of goods (G.S. 25-2A-527(1)) that demonstrably have been intended for the particular lease contract even though those goods are unfinished.

(2) If the goods are unfinished, in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization, an aggrieved lessor or the supplier may either complete manufacture and wholly identify the goods to the lease contract or cease manufacture and lease, sell, or otherwise dispose of the goods for scrap or salvage value or proceed in any other reasonable manner. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-704.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Aggrieved party". Section 1-201(2).
"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).
"Learn". Section 1-201(25).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(*l*).
"Lessor". Section 2A-103(1)(p).
"Rights". Section 1-201(36).
"Supplier". Section 2A-103(1)(x).
"Value". Section 1-201(44).

§ 25-2A-525. Lessor's right to possession of goods.

(1) If a lessor discovers the lessee to be insolvent, the lessor may refuse to deliver the goods.

(2) After a default by the lessee under the lease contract of the type described in G.S. 25-2A-523(1) or G.S. 25-2A-523(3)(a) or, if agreed, after other default by the lessee, the lessor has the right to take possession of the goods. If the lease contract so provides, the lessor may require the lessee to assemble the goods and make them available to the lessor at a place to be designated by the lessor which is reasonably convenient to both parties. Without removal, the lessor may render unusable any goods employed in trade or business, and may dispose of goods on the lessee's premises (G.S. 25-2A-527).

(3) The lessor may proceed under subsection (2) of this section without judicial process if it can be done without breach of the peace or the lessor may proceed by action. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-702(1) and 9-503.

Changes: Substantially revised.

Purposes:

1. Subsection (1), a revised version of the provisions of Section 2-702(1), allows the lessor to refuse to deliver goods if the

lessee is insolvent. Note that the provisions of Section 2-702(2), granting the unpaid seller certain rights of reclamation, were not incorporated in this section. Subsection (2) made this unnecessary.

2. Subsection (2), a revised version of the provisions of Section 9-503, allows the lessor, on a Section 2A-523(1) or 2A-523(3)(a) default by the lessee, the right to take possession of or reclaim the goods. Also, the lessor can contract for the right to take possession of the goods for other defaults by the lessee. Therefore, since the lessee's insolvency is an event of default in a standard lease agreement, subsection (2) is the functional equivalent of Section 2-702(2). Further, subsection (2) sanctions the classic crate and delivery clause obligating the lessee to assemble the goods and to make them available to the lessor. Finally, the lessor may leave the goods in place, render them unusable (if they are goods employed in trade or business), and dispose of them on the lessee's premises.

3. Subsection (3), a revised version of the provisions of Section 9-503, allows the lessor to proceed under subsection (2) without judicial process, absent breach of the peace, or by action. Sections 2A-501(3), 2A-103(4) and 1-201(1). In the appropriate case action includes injunctive relief. Clark Equip. Co. v. Armstrong Equip. Co., 431 F.2d 54 (5th Cir. 1970), cert. denied, 402 U.S. 909 (1971). This Section, as well as a number of other Sections in this Part, are included in the Article to codify the lessor's common law right to protect the lessor's reversionary interest in the goods. Section 2A-103(1)(q). These Sections are intended to supplement and not displace principles of law and equity with respect to the protection of such interest. Sections 2A-103(4) and 1-103. Such principles apply in many instances, e.g., loss or damage to goods if risk of loss passes to the lessee, failure of the lessee to return goods to the lessor in the condition stipulated in the lease, and refusal of the lessee to return goods to the lessor after termination or cancellation of the lease. See also Section 2A-532.

Cross References:

Sections 1-106(2), 2-702(1), 2-702(2), 2A-103(4), 2A-501(3), 2A-532 and 9-503.

Definitional Cross References:

"Action". Section 1-201(1).
"Delivery". Section 1-201(14).
"Discover". Section 1-201(25).
"Goods". Section 2A-103(1)(h).
"Insolvent". Section 1-201(23).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).
"Rights". Section 1-201(36).

§ 25-2A-526. Lessor's stoppage of delivery in transit or otherwise.

(1) A lessor may stop delivery of goods in the possession of a carrier or other bailee if the lessor discovers the lessee to be insolvent and may stop delivery of carload, truckload, planeload, or larger shipments of express or freight if the lessee repudiates or fails to make a payment due before delivery, whether for rent, security, or otherwise under the lease contract, or for any other reason the lessor has a right to withhold or take possession of the goods.

(2) In pursuing its remedies under subsection (1) of this section, the lessor may stop delivery until

(a) receipt of the goods by the lessee;

(b) acknowledgment to the lessee by any bailee of the goods, except a carrier, that the bailee holds the goods for the lessee; or

(c) such an acknowledgment to the lessee by a carrier via reshipment or as warehouseman.

(3)(a) To stop deliver [delivery], a lessor shall so notify as to enable the bailee by reasonable diligence to prevent delivery of the goods.

(b) after notification, the bailee shall hold and deliver the goods according to the directions of the lessor, but the lessor is liable to the bailee for any ensuing charges or damages.

(c) a carrier who has issued a nonnegotiable bill of lading is not obliged to obey a notification to stop received from a person other than the consignor. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-705.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:
"Bill of lading". Section 1-201(6).
"Delivery". Section 1-201(14).
"Discover". Section 1-201(25).
"Goods". Section 2A-103(1)(h).
"Insolvent". Section 1-201(23).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notifies" and "Notification". Section 1-201(26).
"Person". Section 1-201(30).
"Receipt". Section 2-103(1)(c).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).

Editor's Note. — The word "delivery" has been inserted in brackets in subdivision (3)(a) above as the word probably intended by the legislature.

§ 25-2A-527. Lessor's rights to dispose of goods.

(1) After a default by a lessee under the lease contract of the type described in G.S. 25-2A-523(1) or G.S. 25-2A-523(3)(a) or after the lessor refuses to deliver or takes possession of goods (G.S. 25-2A-525 or G.S. 25-2A-526), or, if agreed, after other default by a lessee, the lessor may dispose of the goods concerned or the undelivered balance thereof by lease, sale, or otherwise.

(2) Except as otherwise provided with respect to damages liquidated in the lease agreement (G.S. 25-2A-504) or otherwise determined pursuant to agreement of the parties (G.S. 25-1-102(3) and G.S. 25-2A-503), if the disposition is by lease agreement substantially similar to the original lease agreement and the new lease agreement is made in good faith and in a commercially reasonable manner, the lessor may recover from the lessee as damages (i) accrued and unpaid rent as of the date of the commencement of the term of the new lease agreement, (ii) the present value, as of the same date, of the total rent for the then remaining lease term of the original lease agreement minus the present value, as of the same date, of the rent under the new lease agreement applicable to that period of the new lease term which is comparable to the then remaining term of the original lease agreement, and (iii) any incidental damages allowed under G.S. 25-2A-530, less expenses saved in consequence of the lessee's default.

(3) If the lessor's disposition is by lease agreement that for any reason does not qualify for treatment under subsection (2) of this section, or is by sale or otherwise, the lessor may recover from the lessee as if the lessor had elected not to dispose of the goods and G.S. 25-2A-528 governs.

(4) A subsequent buyer or lessee who buys or leases from the lessor in good faith for value as a result of a disposition under this section takes the goods free of the original lease contract and any

rights of the original lessee even though the lessor fails to comply with one or more of the requirements of this Article.

(5) The lessor is not accountable to the lessee for any profit made on any disposition. A lessee who has rightfully rejected or justifiably revoked acceptance shall account to the lessor for any excess over the amount of the lessee's security interest (G.S. 25-2A-508(5)). (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-706(1), (5) and (6).

Changes: Substantially revised.

Purposes:

1. Subsection (1), a revised version of the first sentence of subsection 2-706(1), allows the lessor the right to dispose of goods after a statutory or other material default by the lessee (even if the goods remain in the lessee's possession — Section 2A-525(2)), after the lessor refuses to deliver or takes possession of the goods, or, if agreed, after other contractual default. The lessor's decision to exercise this right is a function of a commercial judgment, not a statutory mandate replete with sanctions for failure to comply. Cf. Section 9-507. As the owner of the goods, in the case of a lessor, or as the prime lessee of the goods, in the case of a sublessor, compulsory disposition of the goods is inconsistent with the nature of the interest held by the lessor or the sublessor and is not necessary because the interest held by the lessee or the sublessee is not protected by a right of redemption under the common law or this Article. Subsection 2A-527(5).

2. The rule for determining the measure of damages recoverable by the lessor against the lessee is a function of several variables. If the lessor has elected to effect disposition under subsection (1) and such disposition is by lease that qualifies under subsection (2), the measure of damages set forth in subsection (2) will apply, absent agreement to the contrary. Sections 2A-504, 2A-103(4) and 1-102(3).

3. The lessor's damages will be established using the new lease agreement as a measure if the following three criteria are satisfied: (i) the lessor disposed of the goods by lease, (ii) the lease agreement is substantially similar to the original lease agreement, and (iii) such disposition was in good faith, and in a commercially reasonable manner. Thus, the lessor will be entitled to recover from the lessee the accrued and unpaid rent as of the date of commencement of the term of the new lease, and the present value, as of the same date of the rent under the original lease for the then remaining term less the present value as of the same date of the rent under the new lease agreement applicable to the period of the new lease comparable to the remaining term under the original lease, together with incidental damages less expenses saved in consequence of the lessee's default. If the lessor's disposition does not satisfy the criteria of subsection (2), the lessor may calculate its claim against the lessee pursuant to Section 2A-528. Section 2A-523(1)(e).

4. Two of the three criteria to be met by the lessor are familiar, but the concept of the new lease agreement that is substantially similar to the original lease agreement is not. Given the many variables facing a party who intends to lease goods and the rapidity of change in the market place, the policy decision was made not to draft with specificity. It was thought unwise to seek to establish certainty at the cost of fairness. The decision of whether the new lease agreement is substantially similar to the original will be determined case by case.

5. While the section does not draw a bright line, it is possible to describe some of the factors that should be considered in a finding that a new lease agreement is substantially similar to the original. The various elements of the new lease agreement should be examined. Those elements include the options to purchase or release; the lessor's representations, warranties and covenants to the lessee as well as those to be provided by the lessee to the lessor; and the services, if any, to be provided by the lessor or by the lessee. All of these factors allocate cost and risk between the lessor and the lessee and thus affect the amount of rent to be paid. These findings should not be made with scientific precision, as they are a function of economics, nor should they be made independently, as it is important that a sense of commer-

cial judgment pervade the finding. See Section 2A-507(2). To establish the new lease as a proper measure of damage under subsection (2), these various factors, taken as a whole, must result in a finding that the new lease agreement is substantially similar to the original. If the differences between the original lease and the new lease can be easily valued, it would be appropriate for a court to find that the new lease is substantially similar to the old lease, adjust the difference in the rent between the two leases to take account of the differences, and award damages under this section. If, for example, the new lease requires the lessor to insure the goods in the hands of the lessee, while the original lease required the lessee to insure, the usual cost of such insurance could be deducted from rent due under the new lease before the difference in rental between the two leases is determined.

6. The following hypothetical illustrates the difficulty of providing a bright line. Assume that A buys a jumbo tractor for $1 million and then leases the tractor to B for a term of 36 months. The tractor is delivered to and is accepted by B on May 1. On June 1 B fails to pay the monthly rent to A. B returns the tractor to A, who immediately releases the tractor to C for a term identical to the term remaining under the lease between A and B. All terms and conditions under the lease between A and C are identical to those under the original lease between A and B, except that C does not provide any property damage or other insurance coverage, and B agreed to provide complete coverage. Coverage is expensive and difficult to obtain. It is a question of fact whether it is so difficult to adjust the recovery to take account of the difference between the two leases as to insurance that the second lease is not substantially similar to the original.

7. A new lease can be substantially similar to the original lease even though its term extends beyond the remaining term of the original lease, so long as both (a) the lease terms are commercially comparable (e.g., it is highly unlikely that a one-month rental and a five-year lease would reflect similar realities), and (b) the court can fairly apportion a part of the rental payments under the new lease to that part of the term of the new lease which is comparable to the remaining lease term under the original lease. Also, the lease term of the new lease may be comparable to the remaining term of the original lease even though the beginning and ending dates of the two leases are not the same. For example, a two-month lease of agricultural equipment for the months of August and September may be comparable to a two-month lease running from the 15th of August to the 15th of October if in the particular location two-month leases beginning on August 15th are basically interchangeable with two-month leases beginning August 1st. Similarly, the term of a one-year truck lease beginning on the 15th of January may be comparable to the term of a one-year truck lease beginning January 2nd. If the lease terms are found to be comparable, the court may base cover damages on the entire difference between the costs under the two leases.

8. Subsection (3), which is new, provides that if the lessor's disposition is by lease that does not qualify under subsection (2), or is by sale or otherwise, Section 2A-528 governs.

9. Subsection (4), a revised version of subsection 2-706(5), applies to protect a subsequent buyer or lessee who buys or leases from the lessor in good faith and for value, pursuant to disposition under this section. Note that by its terms, the rule in subsection 2A-304(1), which provides that the subsequent lessee takes subject to the original lease contract, is controlled by the rule stated in this subsection.

10. Subsection (5), a revised version of subsection 2-706(6), provides that the lessor is not accountable to the lessee for any profit made by the lessor on a disposition. This rule follows from the fundamental premise of the bailment for hire that the lessee under a lease of good has no equity of redemption to protect.

Cross References:

Sections 1-102(3), 2-706(1), 2-706(5), 2-706(6), 2A-103(4), 2A-304(1), 2A-504, 2A-507(2), 2A-523(1)(e), 2A-525(2), 2A-517(5), 2A-528 and 9-507.

Definitional Cross References:

"Buyer" and "Buying". Section 2-103(1)(a).

"Delivery". Section 1-201(14).

"Good faith". Sections 1-201(19) and 2-103(1)(b).

"Goods". Section 2A-103(1)(h).

"Lease". Section 2A-103(1)(j).

"Lease contract". Section 2A-103(1)(*l*).

"Lessee". Section 2A-103(1)(n).

"Lessor". Section 2A-103(1)(p).

"Present value". Section 2A-103(1)(u).

"Rights". Section 1-201(36).
"Sale". Section 2-106(1).
"Security interest". Section 1-201(37).
"Value". Section 1-201(44).

§ 25-2A-528. Lessor's damages for nonacceptance, failure to pay, repudiation, or other default.

(1) Except as otherwise provided with respect to damages liquidated in the lease agreement (G.S. 25-2A-504) or otherwise determined pursuant to agreement of the parties (G.S. 25-1-102(3) and G.S. 25-2A-503), if a lessor elects to retain the goods or a lessor elects to dispose of the goods and the disposition is by lease agreement that for any reason does not qualify for treatment under G.S. 25-2A-527(2), or is by sale or otherwise, the lessor may recover from the lessee as damages for a default of the type described in G.S. 25-2A-523(1) or G.S. 25-2A-523(3)(a), or if agreed, for other default of the lessee, (i) accrued and unpaid rent as of the date of default if the lessee has never taken possession of the goods, or, if the lessee has taken possession of the goods, as of the date the lessor repossesses the goods or an earlier date on which the lessee makes a tender of the goods to the lessor, (ii) the present value as of the date determined under clause (i) of the total rent for the then remaining lease term of the original lease agreement minus the present value as of the same date of the market rent at the place where the goods are located computed for the same lease term, and (iii) any incidental damages allowed under G.S. 25-2A-530, less expenses saved in consequence of the lessee's default.

(2) If the measure of damages provided in subsection (1) of this section, is inadequate to put a lessor in as good a position as performance would have, the measure of damages is the present value of the profit, including reasonable overhead, the lessor would have made from full performance by the lessee, together with any incidental damages allowed under G.S. 25-2A-530, due allowance for costs reasonably incurred and due credit for payments or proceeds of disposition. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-708.

Changes: Substantially revised.

Purposes:

1. Subsection (1), a substantially revised version of Section 2-708(1), states the basic rule governing the measure of lessor's damages for a default described in Section 2A-523(1) or (3)(a), and, if agreed, for a contractual default. This measure will apply if the lessor elects to retain the goods (whether undelivered, returned by the lessee, or repossessed by the lessor after acceptance and default by the lessee) or if the lessor's disposition does not qualify under subsection 2A-527(2). Section 2A-527(3). Note that under some of these conditions, the lessor may recover damages from the lessee pursuant to the rule set forth in Section 2A-529. There is no sanction for disposition that does not qualify under subsection 2A-527(2). Application of the rule set forth in this section is subject to agreement to the contrary. Sections 2A-504, 2A-103(4) and 1-102(3).

2. If the lessee has never taken possession of the goods, the measure of damage is the accrued and unpaid rent as of the date of default together with the present value, as of the date of default, of the original rent for the remaining term of the lease less the present value as of the same date of market rent, and incidental damages, less expenses saved in consequence of the default. Note that the reference in Section 2A-528(1)(i) and (ii) is

to the date of default not to the date of an event of default. An event of default under a lease agreement becomes a default under a lease agreement only after the expiration of any relevant period of grace and compliance with any notice requirements under this Article and the lease agreement. American Bar Foundation, Commentaries on Indentures, § 5-1, at 216-217 (1971). Section 2A-501(1). This conclusion is also a function of whether, as a matter of fact or law, the event of default has been waived, suspended or cured. Sections 2A-103(4) and 1-103. If the lessee has taken possession of the goods, the measure of damages is the accrued and unpaid rent as of the earlier of the time the lessor repossesses the goods or the time the lessee tenders the goods to the lessor plus the difference between the present value, as of the same time, of the rent under the lease for the remaining lease term and the present value, as of the same time, of the market rent.

3. Market rent will be computed pursuant to Section 2A-507.

4. Subsection (2), a somewhat revised version of the provisions of subsection 2-708(2), states a measure of damages which applies if the measure of damages in subsection (1) is inadequate to put the lessor in as good a position as performance would have. The measure of damage is the lessor's profit, including overhead, together with incidental damages, with allowance for costs reasonably incurred and credit for payments or proceeds of disposition. In determining the amount of due credit with respect to proceeds of disposition a proper value should be attributed to the lessor's residual interest in the goods. Sections 2A-103(1)(q) and 2A-507(4).

5. In calculating profit, a court should include any expected appreciation of the goods, e.g. the foal of a leased brood mare. Because this subsection is intended to give the lessor the benefit of the bargain, a court should consider any reasonable benefit or profit expected by the lessor from the performance of the lease agreement. See Honeywell, Inc. v. Lithonia Lighting, Inc., 317 F.Supp. 406, 413 (N.D.Ga.1970); Locks v. Wade, 36 N.J.Super. 128, 131, 114 A.2d 875, 877 (Super.Ct.App.Div.1955). Further, in calculating profit the concept of present value must be given effect. Taylor v. Commercial credit Equip. Corp., 170 Ga.App. 322, 316 S.E.2d 788 (Ct.App.1984). See generally Section 2A-103(1)(u).

Cross References:

Sections 1-102(3), 2-708, 2A-103(1)(u), 2A-402, 2A-504, 2A-507, 2A-527(2) and 2A-529.

Definitional Cross References:

"Agreement". Section 1-201(3).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).
"Present value". Section 2A-103(1)(u).
"Sale". Section 2-106(1).

§ 25-2A-529. Lessor's action for the rent.

(1) After default by the lessee under the lease contract of the type described in G.S. 25-2A-523(1) or G.S. 25-2A-523(3)(a) or, if agreed, after other default by the lessee, if the lessor complies with subsection (2) of this section, the lessor may recover from the lessee as damages:

(a) for goods accepted by the lessee and not repossessed by or tendered to the lessor, and for conforming goods lost or damaged within a commercially reasonable time after risk of loss passes to the lessee (G.S. 25-2A-219), (i) accrued and unpaid rent as of the date of entry of judgment in favor of the lessor, (ii) the present value as of the same date of the rent for the then remaining lease term of the lease agreement, and (iii) any incidental damages allowed under G.S. 25-2A-530, less expenses saved in consequence of the lessee's default; and

(b) for goods identified to the lease contract if the lessor is unable after reasonable effort to dispose of them at a reasonable price or the circumstances reasonably indicate that effort will be unavailing, (i) accrued and unpaid rent as of the date of entry of judgment in favor of the lessor, (ii) the present value as of the same date of the rent for the then remaining lease term of the lease agreement, and (iii) any incidental damages allowed under G.S. 25-2A-530, less expenses saved in consequence of the lessee's default.

(2) Except as provided in subsection (3) of this section, the lessor shall hold for the lessee for the remaining lease term of the lease agreement any goods that have been identified to the lease contract and are in the lessor's control.

(3) The lessor may dispose of the goods at any time before collection of the judgment for damages obtained pursuant to subsection (1) of this section. If the disposition is before the end of the remaining lease term of the lease agreement, the lessor's recovery against the lessee for damages is governed by G.S. 25-2A-527 or G.S. 25-2A-528, and the lessor will cause an appropriate credit to be provided against a judgment for damages to the extent that the amount of the judgment exceeds the recovery available pursuant to G.S. 25-2A-527 or G.S. 25-2A-528.

(4) Payment of the judgment for damages obtained pursuant to subsection (1) of this section, entitles the lessee to the use and possession of the goods not then disposed of for the remaining lease term of and in accordance with the lease agreement.

(5) After a default by the lessee under the lease contract of the type described in G.S. 25-2A-523(1) or G.S. 25-2A-523(3)(a) or, if agreed, after other default by the lessee, a lessor who is held not entitled to rent under this section must nevertheless be awarded damages for nonacceptance under G.S. 25-2A-527 or G.S. 25-2A-528. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-709.

Changes: Substantially revised.

Purposes:

1. Absent a lease contract provision to the contrary, an action for the full unpaid rent (discounted to present value as of the time of entry of judgment as to rent due after that time) is available as to goods not lost or damaged only if the lessee retains possession of the goods or the lessor is or apparently will be unable to dispose of them at a reasonable price after reasonable effort. There is no general right in a lessor to recover the full rent from the lessee upon holding the goods for the lessee. If the lessee tenders goods back to the lessor, and the lessor refuses to accept the tender, the lessor will be limited to the damages it would have suffered had it taken back the goods. The rule in Article 2 that the seller can recover the price of accepted goods is rejected here. In a lease, the lessor always has a residual interest in the goods which the lessor usually realizes upon at the end of a lease term by either sale or a new lease. Therefore, it is not a substantial imposition on the lessor to require it to take back and dispose of the goods if the lessee chooses to tender them back before the end of the lease term: the lessor will merely do earlier what it would have done any way, sell or relet the goods. Further, the lessee will frequently encounter substantial difficulties if the lessee attempts to sublet the goods for the remainder of the lease term. In contrast to the buyer who owns the entire interest in goods and can easily dispose of them, the lessee is selling only the right to use the goods under the terms of the lease and the sublessee must assume a relationship with the lessor. In that situation, it is usually more efficient to eliminate the original lessee as a middleman by allowing the lessee to return the goods to the lessor who can then redispose of them.

2. In some situations even where possession of the goods is reacquired, a lessor will be able to recover as damages the present value of the full rent due, not under this section, but under 2A-528(2) which allows a lost profit recovery if necessary to put the lessor in the position it would have been in had the lessee performed. Following is an example of such a case. A is a lessor of construction equipment and maintains a substantial inventory. B leases from A a backhoe for a period of two weeks at a rental of $1,000. After three days, B returns the backhoe and refuses to pay the rent. A has five backhoes in inventory, including the one returned by B. During the next 11 days after the return by B of the backhoe, A rents no more than three backhoes at any one time and, therefore, always has two on hand. If B had kept the backhoe for the full rental period. A would have earned the full rental on that backhoe, plus the rental on the other backhoes it actually did rent during that period. Getting this backhoe back before the end of the lease term did not enable A to make any leases it would not otherwise have made. The only way to put A in the position it would have been in had the lessee fully performed is to give the lessor the full rentals. A realized no savings at all because the backhoe was returned early and might even have incurred additional expense if it was paying for parking space for equipment in inventory. A has no obligation to relet the backhoe for the benefit of B rather than leasing the backhoe or any other in inventory for its own benefit. Further, it is probably not reasonable to expect A to dispose of the backhoe by sale when it is returned in an effort to reduce damages suffered by B. Ordinarily, the loss of a two-week rental would not require A to reduce the size of its backhoe inventory. Whether A would similarly be entitled to full rentals as lost profit in a one-year lease of a backhoe is a question of fact: in any event the lessor, subject to mitigation of damages rules, is entitled to be put in as good a position as it would have been had the lessee fully performed the lease contract.

3. Under subsection (2) a lessor who is able and elects to sue for the rent due under a lease must hold goods not lost or damaged for the lessee. Subsection (3) creates an exception to the subsection (2) requirement. If the lessor disposes of those goods prior to collection of the judgment (whether as a matter of law or agreement), the lessor's recovery is governed by the measure of damages in Section 2A-527 if the disposition is by lease that is substantially similar to the original lease, or otherwise by the measure of damages in Section 2A-528. Section 2A-523 official comment.

4. Subsection (4), which is new, further reinforces the requisites of Subsection (2). In the event the judgment for damages obtained by the lessor against the lessee pursuant to subsection (1) is satisfied, the lessee regains the right to use and possession of the remaining goods for the balance of the original lease term; a partial satisfaction of the judgment creates no right in the lessee to use and possession of the goods.

5. The relationship between subsections (2) and (4) is important to understand. Subsection (2) requires the lessor to hold for the lessee identified goods in the lessor's possession. Absent agreement to the contrary, whether in the lease or otherwise, under most circumstances the requirement that the lessor hold the goods for the lessee for the term will mean that the lessor is not allowed to use them. Sections 2A-103(4) and 1-203. Further, the lessor's use of the goods could be viewed as a disposition of the goods that would bar the lessor from recovery under this section, remitting the lessor to the two preceding sections for a determination of the lessor's claim for damages against the lessee.

6. Subsection (5), the analogue of subsection 2-709(3), further reinforces the thrust of subsection (3) by stating that a lessor who is held not entitled to rent under this section has not elected a remedy; the lessor must be awarded damages under Sections 2A-527 and 2A-528. This is a function of two significant policies of this Article — that resort to a remedy is optional, unless expressly agreed to be exclusive (Section 2A-503(2)) and that rights and remedies provided in this Article generally are cumulative. (Section 2A-501(2) and (4)).

Cross References:

Sections 1-203, 2-709, 2-709(3), 2A-103(4), 2A-501(2), 2A-501(4), 2A-503(2), 2A-504, 2A-523(1)(e), 2A-525(2), 2A-527, 2A-528 and 2A-529(2).

Definitional Cross References:

"Action". Section 1-201(1).
"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).

"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-102(1)(n).
"Lessor". Section 2A-103(1)(p).
"Present value". Section 2A-103(1)(u).
"Reasonable time". Section 1-204(1) and (2).

§ 25-2A-530. Lessor's incidental damages.

Incidental damages to an aggrieved lessor include any commercially reasonable charges, expenses, or commissions incurred in stopping delivery, in the transportation, care, and custody of goods after the lessee's default, in connection with return or disposition of the goods, or otherwise resulting from the default. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-710.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:
"Aggrieved party". Section 1-201(2).
"Delivery". Section 1-201(14).
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).

§ 25-2A-531. Standing to sue third parties for injury to goods.

(1) If a third party so deals with goods that have been identified to a lease contract as to cause actionable injury to a party to the lease contract then (a) the lessor has a right of action against the third party, and (b) the lessee also has a right of action against the third party if the lessee:

(i) has a security interest in the goods;
(ii) has an insurable interest in the goods; or
(iii) bears the risk of loss under the lease contract or has since the injury assumed that risk as against the lessor and the goods have been converted or destroyed.

(2) If at the time of the injury the party plaintiff did not bear the risk of loss as against the other party to the lease contract and there is no arrangement between them for disposition of the recovery, his suit or settlement, subject to his own interest, is as a fiduciary for the other party to the lease contract.

(3) Either party, with the consent of the other, may sue for the benefit of whom it may concern. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-722.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:
"Action". Section 1-201(1).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(*l*).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).
"Rights". Section 1-201(36).
"Security interest". Section 1-201(37).

§ 25-2A-532. Lessor's rights to residual interest.

In addition to any other recovery permitted by this Article or other law, the lessor may recover from the lessee an amount that will fully compensate the lessor for any loss of or damage to the lessor's residual interest in the goods caused by the default of the lessee. (1993, c. 463, s. 1.)

OFFICIAL COMMENT

Uniform Statutory Source: None.

This section recognizes the right of the lessor to recover under this Article (as well as under other law) from the lessee for failure to comply with the lease obligations as to the condition of leased goods when returned to the lessor, for failure to return the goods at the end of the lease, or for any other default which causes loss or injury to the lessor's residual interest in the goods.

ARTICLE 3.

Commercial Paper.

PART 1.

SHORT TITLE, FORM AND INTERPRETATION.

§ 25-3-101. Short title.

Legal Periodicals. —

For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

For article, "The Legal Impact of the Federal Trade Commission's Holder in Due Course Notice on a Negotiable Instrument: How Clever Are the Rascals at the FTC?," see 68 N.C.L. Rev. 953 (1990).

§ 25-3-102. Definitions and index of definitions.

CASE NOTES

I. General Consideration.

I. GENERAL CONSIDERATION.

Subdivision (16) of § 1-52 was not meant to be applicable to specialized causes of action provided for in integrated statutory schemes such as found in Article 3 of Chapter 25. First Investors Corp. v. Citizens Bank, Inc., 757 F. Supp. 687 (W.D.N.C. 1991), aff'd, 956 F.2d 263 (4th Cir. 1992).

§ 25-3-104. Form of negotiable instruments; "draft"; "check"; "certificate of deposit"; "note."

CASE NOTES

I. General Consideration.

I. GENERAL CONSIDERATION.

Note Not Payable to Order or Bearer. —

Certificate of deposit "payable to the Registered Holder, or to the duly registered assignee hereof" was not payable to order or bearer and thus lacked the essential words of negotiability. Furthermore, the certificate contained terms precluding transfer and was nonnegotiable because there was no unconditional promise to pay. Holloway v. Wachovia Bank & Trust Co., 333 N.C. 94, 423 S.E.2d 752 (1992).

In light of the prevailing commercial practices and the purpose of the Uniform Commercial Code (U.C.C.), there exists no compelling reason to classify credit card slips as instruments. They are nontransferable, they are not generally presented back to the issuer in the collection process, and creditors usually have no access to the clearinghouse procedure through which they are paid. Classifying credit card slips as instruments would frustrate prevailing commercial practices. First Union Nat'l Bank v. Brendle's Stores, Inc., 165 Bankr. 811 (M.D.N.C. 1993).

Purchase money security agreement signed by guarantor was not a negotiable instrument because it contained a number of promises in addition to an unconditional promise or order to pay a certain sum. Gregory Poole Equip. Co. v. Murray, 105 N.C. App. 642, 414 S.E.2d 563 (1992).

Interpretation of Negotiable Instrument. — Where the promissory note is a negotiable instrument within the meaning of this section, interpretation of the note is governed by the provisions therein. Smith v. Rushing Constr. Co., 84 N.C. App. 692, 353 S.E.2d 692 (1987).

Applied in A.E. Pennebaker Co. v. Fuller, 691 F. Supp. 938 (W.D.N.C. 1988).

Quoted in In re Foreclosure of First Resort Properties of N.C., Inc., 94 N.C. App. 99, 380 S.E.2d 124 (1989).

§ 25-3-105. When promise or order unconditional.

CASE NOTES

Reference to Separate Agreement. —

Where a promissory note provided that the terms of a collateral agreement were incorporated therein by reference, the promissory note was conditional and therefore not a negotiable instrument. Almond v. Rhyne, 108 N.C. App. 605, 424 S.E.2d 231 (1993).

§ 25-3-110. Payable to order.

CASE NOTES

In light of the prevailing commercial practices and the purpose of the Uniform Commercial Code (U.C.C.), there exists no compelling reason to classify credit card slips as instruments. They are nontransferable, they are not generally presented back to the issuer in the collection process, and creditors usually have no access to the clearinghouse procedure through which they are paid. Classifying credit card slips as instruments would frustrate prevailing commercial practices. First Union Nat'l Bank v. Brendle's Stores, Inc., 165 Bankr. 811 (M.D.N.C. 1993).

Cited in State v. First Resort Properties, 81 N.C. App. 499, 344 S.E.2d 354 (1986).

§ 25-3-114. Date, antedating, postdating.

CASE NOTES

Cited in State v. First Resort Properties, 81 N.C. App. 499, 344 S.E.2d 354 (1986).

§ 25-3-118. Ambiguous terms and rules of construction.

Legal Periodicals. — For note, "Judicially Imposed Usury Penalties in the Absence of Statutory Penalties: Can Freedom of Contract Co-Exist with Public Policy After Merritt v. Knox?," see 68 N.C.L. Rev. 1021 (1990).

CASE NOTES

Unambiguous Words Took Precedence Over Miscalculated Figures. — Where plaintiff brought declaratory judgment proceeding to determine amount he owed defendant under two notes he admittedly assumed, words employed obligated makers without qualification to pay defendant two hundred thousand dollars ($200,000) in principal, not some lesser sum, together with eight percent (8%) interest on the unpaid amount, the only conflict in the notes was that final installments stated in schedules were not sufficient to pay "the total amount of principal and interest then due" as text required, court's conclusion that miscalculated figures in installment schedules were overcome by unambiguous words of notes requiring payment of two hundred thousand dollars ($200,000), together with interest, was correct as matter of law. Gray v. Venters, 92 N.C. App. 589, 374 S.E.2d 889 (1989).

Where interest rate on note was usurious and penalty of forfeiture was barred by the statute of limitation, interest allowed was not the maximum legal rate but the legal or judgment rate. Merritt v. Knox, 94 N.C. App. 340, 380 S.E.2d 160 (1989).

Stated in Smith v. Rushing Constr. Co., 84 N.C. App. 692, 353 S.E.2d 692 (1987).

§ 25-3-119. Other writings affecting instrument.

CASE NOTES

Handwritten agreement between lessees/obligors and representative of lessor/obligee limiting remedies did not qualify as a defense which could be asserted against assignee as a limitation of remedies. Leasing Serv. Corp. v. Crane, 804 F.2d 828 (4th Cir. 1986).

§ 25-3-122. Accrual of cause of action; interest.

Legal Periodicals. — For note, "Judicially Imposed Usury Penalties in the Absence of Statutory Penalties: Can Freedom of Contract Co-Exist with Public Policy After Merritt v. Knox?," see 68 N.C.L. Rev. 1021 (1990).

CASE NOTES

Applied in Merritt v. Knox, 94 N.C. App. 340, 380 S.E.2d 160 (1989).

Cited in State ex rel. Eure v. Lawrence, 93 N.C. App. 446, 378 S.E.2d 207 (1989).

PART 3.

RIGHTS OF A HOLDER.

§ 25-3-302. Holder in due course.

Legal Periodicals. — For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

CASE NOTES

I. General Consideration.

I. GENERAL CONSIDERATION.

Cited in Stewart Office Suppliers, Inc. v. First Union Nat'l Bank, 97 N.C. App. 353, 388 S.E.2d 599 (1990).

§ 25-3-305. Rights of a holder in due course.

CASE NOTES

I. General Consideration.

I. GENERAL CONSIDERATION.

Cited in Stewart Office Suppliers, Inc. v. First Union Nat'l Bank, 97 N.C. App. 353, 388 S.E.2d 599 (1990).

§ 25-3-306. Rights of one not holder in due course.

Legal Periodicals. — For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

§ 25-3-307. Burden of establishing signatures, defenses and due course.

CASE NOTES

I. General Consideration.

I. GENERAL CONSIDERATION.

Quoted in Resolution Trust Corp. v. Southwest Dev. Co., 807 F. Supp. 375 (E.D.N.C. 1992).

Cited in Daye v. Roberts, 89 N.C. App. 344, 365 S.E.2d 660 (1988).

PART 4.

LIABILITY OF PARTIES.

§ 25-3-401. Signature.

CASE NOTES

Cited in Specialty Retail Concepts v. RSB, Inc., 108 Bankr. 104 (W.D.N.C. 1989).

§ 25-3-403. Signature by authorized representative.

CASE NOTES

I. General Consideration.

I. GENERAL CONSIDERATION.

Subdivision (2)(b) has not been specifically extended to contracts other than negotiable instruments. S & F Trading Co. v. Carson, 87 N.C. App. 602, 361 S.E.2d 897 (1987).

Alter Ego Doctrine Inapplicable. —

The general rule is that a person cannot escape liability on his unqualified signature by the mere assertion that he signed as a representative of a corporation. S & F Trading Co. v. Carson, 87 N.C. App. 602, 361 S.E.2d 897 (1987).

Cited in Specialty Retail Concepts v. RSB, Inc., 108 Bankr. 104 (W.D.N.C. 1989).

§ 25-3-404. Unauthorized signatures.

CASE NOTES

I. General Consideration.

I. GENERAL CONSIDERATION.

The initial depository bank which presents a check with a forged indorsement to a collecting or a drawee bank breaches its warranty of good title and, absent an applicable exception becomes liable for the check. Witten Prods., Inc. v. Republic Bank & Trust Co., 102 N.C. App. 88, 401 S.E.2d 388 (1991).

Cited in First Investors Corp. v. Citizens Bank, Inc., 757 F. Supp. 687 (W.D.N.C. 1991).

§ 25-3-405. Impostors; signature in name of payee.

CASE NOTES

Collecting Bank Presenting Forged Indorsement. — A collecting bank does not breach its warranty of good title by presenting a check with a forged, but "effective," indorsement to a drawee bank. Witten Prods., Inc. v. Republic Bank & Trust Co., 102 N.C. App. 88, 401 S.E.2d 388 (1991).

For the loss with regard to a forged indorsement to be placed on the drawer, three conditions must be satisfied: (1) an agent or employee must supply the name of the payee to the drawer, (2) intending that the payee have no interest in the check, and (3) forge an indorsement in the name of the intended payee. Witten Prods., Inc. v. Republic Bank & Trust Co., 102 N.C. App. 88, 401 S.E.2d 388 (1991).

Agency Required for Subdivision (1)(c) to Apply. — It is the existence of an agency relationship, not the scope of the agency, which is required for subdivision (1)(c) of this section to apply. Witten Prods., Inc. v. Republic Bank & Trust Co., 102 N.C. App. 88, 401 S.E.2d 388 (1991).

§ 25-3-406. Negligence contributing to alteration or unauthorized signature.

CASE NOTES

Action under This Section Compared to § 25-3-419 Action. — Where the gravaman of a plaintiff's complaint was that a defendant bank paid over funds to a person who illegally opened a joint account in her and the plaintiff's name on a fraudulent endorsement and failed to adhere to the reasonable commercial standards applicable to banking institutions, such an action was properly grounded in conversion as set forth in § 25-3-419, as opposed to negligence. First Investors Corp. v. Citizens Bank, Inc., 757 F. Supp. 687 (W.D.N.C. 1991), aff'd, 956 F.2d 263 (4th Cir. 1992).

§ 25-3-407. Alteration.

CASE NOTES

I. General Consideration.

I. GENERAL CONSIDERATION.

Applied in Swindell v. Federal Nat'l Mtg. Assoc., 330 N.C. 153, 409 S.E.2d 892 (1991).

§ 25-3-409. Draft not an assignment.

Legal Periodicals. —

For note, "Transfers by Check: The 90-Day Rule of Preference Recovery Under Section 547(b) of the Bankruptcy Code," see 1987 Duke L.J. 712.

CASE NOTES

Quoted in Quinn Whsle., Inc. v. Northen, 100 Bankr. 271 (M.D.N.C. 1988).

§ 25-3-413. Contract of maker, drawer and acceptor.

CASE NOTES

I. General Consideration.

I. GENERAL CONSIDERATION.

Cited in Holloway v. Wachovia Bank & Trust Co., 333 N.C. 94, 423 S.E.2d 752 (1992).

§ 25-3-415. Contract of accommodation party.

CASE NOTES

I. General Consideration.

I. GENERAL CONSIDERATION.

In seeking to ascertain the intent of the parties regarding accommodation status, most courts have adopted some form of the "purpose" and "proceeds" tests. Branch Banking & Trust Co. v. Thompson, 107 N.C. App. 53, 418 S.E.2d 694, cert. denied, 332 N.C. 482, 421 S.E.2d 350 (1992).

Purpose Test. — Under the "purpose" test, the party must have signed the instrument "for the purpose of lending his name to another party to it," whether the creditor would have likely refused the primary maker but for the supposed surety's signature is an important factor to consider. In other words, the accommodating party's signature must have been necessary for the primary maker to get the loan. Branch Banking & Trust Co. v. Thompson, 107 N.C. App. 53, 418 S.E.2d 694, cert. denied, 332 N.C. 482, 421 S.E.2d 350 (1992).

Proceeds Test. — Under the "proceeds" test, the accommodating party cannot receive the primary benefits from the transaction. Branch Banking & Trust Co. v. Thompson, 107 N.C. App. 53, 418 S.E.2d 694, cert. denied, 332 N.C. 482, 421 S.E.2d 350 (1992).

Other factors to consider in determining accommodation status are whether the party took place in negotiations prior to the transaction, and the position of the party's signature on the face of the instrument itself. Branch Banking & Trust Co. v. Thompson, 107 N.C. App. 53, 418 S.E.2d 694, cert. denied, 332 N.C. 482, 421 S.E.2d 350 (1992).

Cited in Gregory Poole Equip. Co. v. Murray, 105 N.C. App. 642, 414 S.E.2d 563 (1992).

§ 25-3-416. Contract of guarantor.

CASE NOTES

Cited in In re Ingersoll, 90 Bankr. 168 (Bankr. W.D.N.C. 1988).

§ 25-3-417. Warranties on presentment and transfer.

Legal Periodicals. —
For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

CASE NOTES

The initial depository bank which presents a check with a forged indorsement to a collecting or a drawee bank breaches its warranty of good title and, absent an applicable exception becomes liable for the check. Witten Prods., Inc. v. Republic Bank & Trust Co., 102 N.C. App. 88, 401 S.E.2d 388 (1991).

§ 25-3-418. Finality of payment or acceptance.

Legal Periodicals. —

For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

CASE NOTES

Action Against Collecting Bank. — This section operates as an exception to the final payment rule in Section 25-4-213(1) only to the extent that it permits the payor bank which has made final payment to seek a recovery against the collecting bank for breach of presentment warranties. United Carolina Bank v. First Union Nat'l Bank, 109 N.C. App. 201, 426 S.E.2d 462 (1993).

§ 25-3-419. Conversion of instrument; innocent representative.

CASE NOTES

I. General Consideration.

I. GENERAL CONSIDERATION.

Action under This Section Compared to § 25-3-406 Action. — Where the gravaman of a plaintiff's complaint was that a defendant bank paid over funds to a person who illegally opened a joint account in her and the plaintiff's name on a fraudulent endorsement and failed to adhere to the reasonable commercial standards applicable to banking institutions, such an action was properly grounded in conversion as set forth in this section, as opposed to negligence, under § 25-3-406. First Investors Corp. v. Citizens Bank, Inc., 757 F. Supp. 687 (W.D.N.C. 1991), aff'd, 956 F.2d 263 (4th Cir. 1992).

The provisions of this section govern allegations which draw into question a depositary bank's handling of instruments presented for deposit on allegedly fraudulent endorsements, as opposed to an ordinary negligence action. First Investors Corp. v. Citizens Bank, Inc., 757 F. Supp. 687 (W.D.N.C. 1991), aff'd, 956 F.2d 263 (4th Cir. 1992).

Statute of Limitations. — If an action is one for conversion, it is clear that the applicable statute of limitations is subsection (4) of § 1-52. First Investors Corp. v. Citizens Bank, Inc., 757 F. Supp. 687 (W.D.N.C. 1991), aff'd, 956 F.2d 263 (4th Cir. 1992).

The "discovery rule," codified at subsection (16) of § 1-52, does not apply to conversion actions. First Investors Corp. v. Citizens Bank, Inc., 757 F. Supp. 687 (W.D.N.C. 1991), aff'd, 956 F.2d 263 (4th Cir. 1992).

Subdivision (16) of § 1-52 was not meant to be applicable to specialized causes of action provided for in integrated statutory schemes such as found in Article 3 of Chapter 25. First Investors Corp. v. Citizens Bank, Inc., 757 F. Supp. 687 (W.D.N.C. 1991), aff'd, 956 F.2d 263 (4th Cir. 1992).

The statute of limitations for conversion is clearly one "otherwise provided by statute" thereby excluded from the purview of subsection (16) of § 1-52. First Investors Corp. v. Citizens Bank, Inc., 757 F. Supp. 687 (W.D.N.C. 1991), aff'd, 956 F.2d 263 (4th Cir. 1992).

Accrual of Cause of Action for Conversion. — The general rule appears to be that conversion actions accrue upon the conversion itself rather than upon its discovery. First Investors Corp. v. Citizens Bank, Inc., 757 F. Supp. 687 (W.D.N.C. 1991), aff'd, 956 F.2d 263 (4th Cir. 1992).

Absolute Liability of Drawee. — The provision of this section that conversion occurs when an instrument is paid on a forged endorsement and the drawee's liability is the face amount of the instrument was intended as a rule of "absolute liability" of the drawee. Cartwood Constr. Co. v. Wachovia Bank & Trust Co., 84 N.C. App. 245, 352 S.E.2d 241, aff'd, 320 N.C. 164, 357 S.E.2d 373 (1987).

Bank's Handling of Instruments as Conversion. — The bank's acceptance of checks bearing allegedly forged endorsements for deposit in the account did not give rise to a separate action for negligence; rather, the bank's duties regarding its handling of the instruments were specifically defined under this section, which gave the nonendorsing party an action in conversion and provided a remedy. Cartwood Constr. Co. v. Wachovia Bank & Trust Co., 84 N.C. App. 245, 352 S.E.2d 241, aff'd, 320 N.C. 164, 357 S.E.2d 373 (1987).

Test of Conversion. — In an action by the nonendorsing party, the name of whose president was allegedly forged on six checks, against the bank for conversion under this section, the critical inquiry was whether the bank dealt with the instrument in good faith and in accordance with reasonable commercial standards, not what interest the plaintiff had in the checks; likewise, in an action against the drawee, the plaintiff's interest in the proceeds of the checks was irrelevant. Cartwood Constr. Co. v. Wachovia Bank & Trust Co., 84 N.C. App. 245, 352 S.E.2d 241, aff'd, 320 N.C. 164, 357 S.E.2d 373 (1987).

Question of Fact. — Where the nonendorsing party made a prima facie showing of the bank's liability under this section, the bank was not entitled to summary judgment on the issue of conversion; rather, the fact finder should have decided whether the instruments in question were actually paid on a forged endorsement and, if so, whether the bank used reasonable commercial standards by paying the instruments, thus limiting recovery to the amount of proceeds remaining in its hands. Cartwood Constr. Co. v. Wachovia Bank & Trust Co., 84 N.C. App. 245, 352 S.E.2d 241, aff'd, 320 N.C. 164, 357 S.E.2d 373 (1987).

PART 5.

PRESENTMENT, NOTICE OF DISHONOR AND PROTEST.

§ 25-3-512. Collection of processing fee for returned checks.

A processing fee, not to exceed twenty dollars ($20.00), may be charged and collected for checks on which payment has been refused by the payor bank because of insufficient funds or because the drawer did not have an account at that bank if at the time the consumer presented the check to the person, a sign:

(1) was conspicuously posted on or in the immediate vicinity of the cash register;

(2) was in plain view of anyone paying for goods or services by check;

(3) was no smaller than 8 by 11 inches; and

(4) stated the amount of the fee that would be charged for returned checks.

When the drawer sends a check by mail for payment of a debt and the check is dishonored and returned, the processing fee may be collected if the drawer was given prior written notice that a fee would be charged for returned checks. Any document that clearly and conspicuously states the amount of the fee that will be charged for returned checks and is delivered to the drawer or his agent, or is mailed first-class mail to the drawer at his last known address as part of any document requesting payment of a debt satisfies this notice requirement for that payment only.

If a collection agency collects or seeks to collect on behalf of its principal a processing fee as specified in this section in addition to the sum payable of a check, the amount of such processing fee must be separately stated on the collection notice. The collection agency shall not collect or seek to collect from the drawer any sum other than the actual amount of the returned check and the specified processing fee. (1981, c. 781, s. 1; 1983, c. 529; 1987, c. 147; 1991, c. 455, s. 1.)

Effect of Amendments. — The 1987 amendment, effective May 7, 1987, substituted "fifteen dollars ($15.00)" for "ten dollars ($10.00)" near the beginning of the introductory paragraph.

The 1991 amendment, effective October 1, 1991, and applicable to checks written on or after that date, in the introductory paragraph, substituted "twenty dollars ($20.00)" for "fifteen dollars ($15.00)."

PART 6.

DISCHARGE.

§ 25-3-603. Payment or satisfaction.

CASE NOTES

Applied in In re Foreclosure of First Resort Properties of N.C., Inc., 94 N.C. App. 99, 380 S.E.2d 124 (1989).

Cited in Holloway v. Wachovia Bank & Trust Co., 333 N.C. 94, 423 S.E.2d 752 (1992).

§ 25-3-605. Cancellation and renunciation.

CASE NOTES

Cited in Almond v. Rhyne, 108 N.C. App. 605, 424 S.E.2d 231 (1993).

§ 25-3-606. Impairment of recourse or of collateral.

CASE NOTES

This section requires that the impairment of collateral be unjustifiable. First Am. Sav. Bank v. Adams, 87 N.C. App. 226, 360 S.E.2d 490 (1987).

Liability of Nonaccommodating Maker. — Nonaccommodating makers and co-makers, alike, are always primarily liable on the debt and only possess a right of contribution against comakers. Sureties, on the other hand, are only secondarily liable on the debt, and retain a right of recourse on the instrument for the full amount owing if they are made to pay. Branch Banking & Trust Co. v. Thompson, 107 N.C. App. 53, 418 S.E.2d 694, cert. denied, 332 N.C. 482, 421 S.E.2d 350 (1992).

Availability of Defense of Discharge. — The defense of discharge provided in § 25-3-606 is available to all parties who occupy the position of an accommodation party and is not available to nonaccomodating makers or comakers. Branch Banking & Trust Co. v. Thompson, 107 N.C. App. 53, 418 S.E.2d 694, cert. denied, 332 N.C. 482, 421 S.E.2d 350 (1992).

Material Alteration as Discharge of Guarantor. — As a general rule, material alteration of the contract between the principal debtor and the creditor without the guarantor's consent will operate to discharge a guarantor. First Am. Sav. Bank v. Adams, 87 N.C. App. 226, 360 S.E.2d 490 (1987).

The general rule in this State is that a material alteration of a contract between a principal debtor and creditor without the guarantor's consent will discharge the guarantor from its obligation. Kirkhart v. Saieed, 98 N.C. App. 49, 389 S.E.2d 837 (1990).

A guarantor is discharged when the debtor and lender enter into a

binding agreement to extend the time for repayment on the theory that the guarantor's right to repay the debt and proceed against the debtor for repayment has been impaired by the agreement. First Am. Sav. Bank v. Adams, 87 N.C. App. 226, 360 S.E.2d 490 (1987).

If a creditor enters into a binding agreement to extend the time of payment or performance, there has been a material alteration sufficient to discharge a guarantor. However, in order to be binding, the agreement must be supported by consideration and must set a definite time for repayment. First Am. Sav. Bank v. Adams, 87 N.C. App. 226, 360 S.E.2d 490 (1987).

Subsection (1)(b) limits the defense of discharge to those who sign an instrument as an accommodation party (surety), a position which an ordinary, nonaccomodating, maker or co-maker does not occupy. Branch Banking & Trust Co. v. Thompson, 107 N.C. App. 53, 418 S.E.2d 694, cert. denied, 332 N.C. 482, 421 S.E.2d 350 (1992).

Stated in First Citizens Bank & Trust Co. v. McLamb, 112 N.C. App. 645, 439 S.E.2d 166 (1994).

PART 8.

MISCELLANEOUS.

§ 25-3-802. Effect of instrument on obligation for which it is given.

Legal Periodicals. —

For note, "Transfers by Check: The 90-Day Rule of Preference Recovery Under Section 547(b) of the Bankruptcy Code," see 1987 Duke L.J. 712.

CASE NOTES

Evidence Showing Payment in Full of Underlying Obligations. — Evidence was sufficient to show that there had been payment in full of underlying obligations pursuant to subdivision (1)(a) where the checks in question were indorsed to lender and he indorsed the checks in blank, annotations on each check noted that the check was in payment of the amounts due on the loans (the underlying obligations), and lender received a check constituting partial satisfaction of the debt and a deposit slip showing a deposit into lender's account in the amount of the remainder. In re Foreclosure of First Resort Properties of N.C., Inc., 94 N.C. App. 99, 380 S.E.2d 124, aff'd, 326 N.C. 357, 388 S.E.2d 769 (1990).

§ 25-3-804. Lost, destroyed or stolen instruments.

CASE NOTES

Cited in Holloway v. Wachovia Bank & Trust Co., 333 N.C. 94, 423 S.E.2d 752 (1992).

§ 25-3-805. Instruments not payable to order or to bearer.

CASE NOTES

Quoted in In re Foreclosure of First Resort Properties of N.C., Inc., 94 N.C. App. 99, 380 S.E.2d 124 (1989).

Cited in Holloway v. Wachovia Bank & Trust Co., 333 N.C. 94, 423 S.E.2d 752 (1992).

ARTICLE 4.

Bank Deposits and Collections.

PART 1.

GENERAL PROVISIONS AND DEFINITIONS.

§ 25-4-101. Short title.

Legal Periodicals. — For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

§ 25-4-104. Definitions and index of definitions.

Legal Periodicals. — For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

CASE NOTES

Cited in United Carolina Bank v. First Union Nat'l Bank, 109 N.C. App. 201, 426 S.E.2d 462 (1993).

§ 25-4-105. "Depositary bank"; "intermediary bank"; "collecting bank"; "payor bank"; "presenting bank"; "remitting bank."

CASE NOTES

Cited in Cartwood Constr. Co. v. Wachovia Bank & Trust Co., 84 N.C. App. 245, 352 S.E.2d 241 (1987).

PART 2.

COLLECTION OF ITEMS: DEPOSITARY AND COLLECTING BANKS.

§ 25-4-205. Supplying missing indorsement; no notice from prior indorsement.

CASE NOTES

Stated in United Carolina Bank v. First Union Nat'l Bank, 109 N.C. App. 201, 426 S.E.2d 462 (1993).

§ 25-4-207. Warranties of customer and collecting bank on transfer or presentment of items; time for claims.

CASE NOTES

Action for Breach of Presentment Warranties. — Although a collecting bank was entitled to recover on its claim that a payor bank unlawfully charged back a check to the collecting bank's account, after the drawer had discovered a missing endorsement, the payor bank was entitled to recover on its claim against the collecting bank for breach of presentment warranty of good title. United Carolina Bank v. First Union Nat'l Bank, 109 N.C. App. 201, 426 S.E.2d 462 (1993).

§ 25-4-213. Final payment of item by payor bank; when provisional debits and credits become final; when certain credits become available for withdrawal.

Legal Periodicals. — For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

CASE NOTES

Action Against Collecting Bank for Breach of Presentment Warranty. — Although a collecting bank was entitled to recover on its claim that a payor bank unlawfully charged back a check to the collecting bank's account, after the drawer had discovered a missing endorsement, the payor bank was entitled to recover on its claim against the collecting bank for breach of presentment warranty of good title. United Carolina Bank v. First Union Nat'l Bank, 109 N.C. App. 201, 426 S.E.2d 462 (1993).

A payor bank's right to recover for breach of presentment warranties does not undo or negate its final payment to collecting bank under subsection (1) of this section. United Carolina Bank v. First Union Nat'l Bank, 109 N.C. App. 201, 426 S.E.2d 462 (1993).

PART 3.

COLLECTION OF ITEMS: PAYOR BANKS.

§ 25-4-301. Deferred posting; recovery of payment by return of items; time of dishonor.

Legal Periodicals. — For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

CASE NOTES

Cited in United Carolina Bank v. First Union Nat'l Bank, 109 N.C. App. 201, 426 S.E.2d 462 (1993).

§ 25-4-302. Payor bank's responsibility for late return of item.

Legal Periodicals. — For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

ARTICLE 4A.

Funds Transfers.

Editor's Note. — Official Comments in Article 4A: Copyright 1993 by the American Law Institute and the National Conference of Commissioners on Uniform State Laws. Reprinted with permission of the Permanent Editorial Board of the Uniform Commercial Code.

PART 1.

SUBJECT MATTER AND DEFINITIONS.

§ 25-4A-101. Short title.

This Article may be cited as Uniform Commercial Code—Funds Transfers. (1993, c. 157, s. 1.)

Editor's Note. — Session Laws 1993, c. 157, which enacted this Article, in s. 3 provides: "The Revisor of Statutes shall cause to be printed along with this act all relevant portions of the official comments to the Uniform Commercial Code, Article 4A, as the Revisor deems appropriate."

Effect of Amendments. — Session Laws 1993, c. 157, s. 4 made this Article effective October 1, 1993.

§ 25-4A-102. Subject matter.

Except as otherwise provided in G.S. 25-4A-108, this Article applies to funds transfers defined in G.S. 25-4A-104. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

Article 4A governs a specialized method of payment referred to in the Article as a funds transfer but also commonly referred to in the commercial community as a wholesale wire transfer. A funds transfer is made by means of one or more payment orders. The scope of Article 4A is determined by the definitions of "payment order" and "funds transfer" found in Section 4A-103 and Section 4A-104.

The funds transfer governed by Article 4A is in large part a product of recent and developing technological changes. Before this Article was drafted there was no comprehensive body of law — statutory or judicial — that defined the juridical nature of a funds transfer or the rights and obligations flowing from payment orders. Judicial authority with respect to funds transfers is sparse, undeveloped and not uniform. Judges have had to resolve disputes by referring to general principles of common law or equity, or they have sought guidance in statutes such as Article 4 which are applicable to other payment methods. But attempts to define rights and obligations in funds transfers by general principles or by analogy to rights and obligations in negotiable instrument law or the law of check collection have not been satisfactory.

In the drafting of Article 4A, a deliberate decision was made to write on a clean slate and to treat a funds transfer as a unique method of payment to be governed by unique rules that address the particular issues raised by this method of payment. A deliberate decision was also made to use precise and detailed rules to assign responsibility, define behavioral norms, allocate risks and establish limits on liability, rather than to rely on broadly stated, flexible principles. In the drafting of these rules, a critical consideration was that the various parties to funds transfers need to be able to predict risk with certainty, to insure against risk, to adjust operational and security procedures, and to price funds transfer services appropriately. This consideration is particularly important given the very large amounts of money that are involved in funds transfers.

Funds transfers involve competing interests — those of the banks that provide funds transfer services and the commercial and financial organizations that use the services, as well as the public interest. These competing interests were represented in the drafting process and they were thoroughly considered. The rules that emerged represent a careful and delicate balancing of those interests and are intended to be the exclusive means of determining the rights, duties and liabilities of the affected parties in any situation covered by particular provisions of the Article. Consequently, resort to principles of law or equity outside of Article 4A is not appropriate to create rights, duties and liabilities inconsistent with those stated in this Article.

§ 25-4A-103. Payment order — definitions.

(a) In this Article:

(1) "Payment order" means an instruction of a sender to a receiving bank, transmitted orally, electronically, or in writing, to pay, or to cause another bank to pay, a fixed or determinable amount of money to a beneficiary if:

(i) The instruction does not state a condition of payment to the beneficiary other than time of payment,

(ii) The receiving bank is to be reimbursed by debiting an account of, or otherwise receiving payment from, the sender, and

(iii) The instruction is transmitted by the sender directly to the receiving bank or to an agent, funds-transfer system, or communication system for transmittal to the receiving bank.

(2) "Beneficiary" means the person to be paid by the beneficiary's bank.

(3) "Beneficiary's bank" means the bank identified in a payment order in which an account of the beneficiary is to be credited pursuant to the order or which otherwise is to make payment to the beneficiary if the order does not provide for payment to an account.

(4) "Receiving bank" means the bank to which the sender's instruction is addressed.

(5) "Sender" means the person giving the instruction to the receiving bank.

(b) If an instruction complying with subsection (a)(1) is to make more than one payment to a beneficiary, the instruction is a separate payment order with respect to each payment.

(c) A payment order is issued when it is sent to the receiving bank. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

This section is discussed in the Comment following Section 4A-104.

§ 25-4A-104. Funds transfer — definitions.

In this Article:

(a) "Funds transfer" means the series of transactions, beginning with the originator's payment order, made for the purpose of making payment to the beneficiary of the order. The term includes any payment order issued by the originator's bank or an intermediary bank intended to carry out the originator's payment order. A funds transfer is completed by acceptance by the beneficiary's bank of a payment order for the benefit of the beneficiary of the originator's payment order.

(b) "Intermediary bank" means a receiving bank other than the originator's bank or the beneficiary's bank.

(c) "Originator" means the sender of the first payment order in a funds transfer.

(d) "Originator's bank" means (i) the receiving bank to which the payment order of the originator is issued if the originator is not a bank, or (ii) the originator if the originator is a bank. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. Article 4A governs a method of payment in which the person making payment (the "originator") directly transmits an instruction to a bank either to make payment to the person receiving payment (the "beneficiary") or to instruct some other bank to make payment to the beneficiary. The payment from the originator to the beneficiary occurs when the bank that is to pay the beneficiary becomes obligated to pay the beneficiary. There are two basic definitions: "Payment order" stated in Section 4A-103 and "Funds transfer" stated in Section 4A-104. These definitions, other related definitions, and the scope of Ar-

ticle 4A can best be understood in the context of specific fact situations. Consider the following cases:

Case #1. X, which has an account in Bank A, instructs that bank to pay $1,000,000 to Y's account in Bank A. Bank A carries out X's instruction by making a credit of $1,000,000 to Y's account and notifying Y that the credit is available for immediate withdrawal. The instruction by X to Bank A is a "payment order" which was issued when it was sent to Bank A. Section 4A-103(a)(1) and (c). X is the "sender" of the payment order and Bank A is the "receiving bank." Section 4A-103(a)(5) and (a)(4). Y is the "beneficiary" of the payment order and Bank A is the "beneficiary's bank." Section 4A-103(a)(2) and (a)(3). When Bank A notified Y of receipt of the payment order, Bank A "accepted" the payment order. Section 4A-209(b)(1). When Bank A accepted the order it incurred an obligation to Y to pay the amount of the order. Section 4A-404(a). When Bank A accepted X's order, X incurred an obligation to pay Bank A the amount of the order. Section 4A-402(b). Payment from X to Bank A would normally be made by a debit to X's account in Bank A. Section 4A-403(a)(3). At the time Bank A incurred the obligation to pay Y, payment of $1,000,000 by X to Y was also made. Section 4A-406(a). Bank A paid Y when it gave notice to Y of a withdrawable credit of $1,000,000 to Y's account. Section 4A-405(a). The overall transaction, which comprises the acts of X and Bank A, in which the payment by X to Y is accomplished is referred to as the "funds transfer." Section 4A-104(a). In this case only one payment order was involved in the funds transfer. A one-payment-order funds transfer is usually referred to as a "book transfer" because the payment is accomplished by the receiving bank's debiting the account of the sender and crediting the account of the beneficiary in the same bank. X, in addition to being the sender of the payment order to Bank A, is the "originator" of the funds transfer. Section 4A-104(c). Bank A is the "originator's bank" in the funds transfer as well as the beneficiary's bank. Section 4A-104(d).

Case #2. Assume the same facts as in Case #1 except that X instructs Bank A to pay $1,000,000 to Y's account in Bank B. With respect to this payment order, X is the sender, Y is the beneficiary, and Bank A is the receiving bank. Bank A carries out X's order by instructing Bank B to pay $1,000,000 to Y's account. This instruction is a payment order in which Bank A is the sender, Bank B is the receiving bank, and Y is the beneficiary. When Bank A issued its payment order to Bank B, Bank A "executed" X's order. Section 4A-301(a). In the funds transfer, X is the originator, Bank A is the originator's bank, and Bank B is the beneficiary's bank. When Bank A executed X's order, X incurred an obligation to pay Bank A the amount of the order. Section 4A-402(c). When Bank B accepts the payment order issued to it by Bank A, Bank B incurs an obligation to Y to pay the amount of the order (Section 4A-404(a)) and Bank A incurs an obligation to pay Bank B. Section 4A-402(b). Acceptance by Bank B also results in payment of $1,000,000 by X to Y. Section 4A-406(a). In this case two payment orders are involved in the funds transfer.

Case #3. Assume the same facts as in Case #2 except that Bank A does not execute X's payment order by issuing a payment order to Bank B. One bank will not normally act to carry out a funds transfer for another bank unless there is a preexisting arrangement between the banks for transmittal of payment orders and settlement of accounts. For example, if Bank B is a foreign bank with which Bank A has no relationship, Bank A can utilize a bank that is a correspondent of both Bank A and Bank B. Assume Bank A issues a payment order to Bank C to pay $1,000,000 to Y's account in Bank B. With respect to this order, Bank A is the sender, Bank C is the receiving Bank, and Y is the beneficiary. Bank C will execute the payment order of Bank A by issuing a payment order to Bank B to pay $1,000,000 to Y's account in Bank B. With respect to Bank C's payment order, Bank C is the sender, Bank B is the receiving bank, and Y is the beneficiary. Payment of $1,000,000 by X to Y occurs when Bank B accepts the payment order issued to it by Bank C. In this case the funds transfer involves three payment orders. In the funds transfer, X is the originator, Bank A is the originator's bank, Bank B is the beneficiary's bank, and Bank C is an "intermediary bank." Section 4A-104(b). In some cases there may be more than one intermediary bank, and in those cases each intermediary bank is treated like Bank C in Case #3.

As the three cases demonstrate, a payment under Article 4A involves an overall transaction, the funds transfer, in which the originator, X, is making payment to the beneficiary, Y, but the funds transfer may encompass a series of payment orders that are issued in order to effect the payment initiated by the originator's payment order.

In some cases the originator and the beneficiary may be the same person. This will occur, for example, when a corporation orders a bank to transfer funds from an account of the corporation in that bank to another account of the corporation in that bank or in some other bank. In some funds transfers the first bank to issue a payment order is a bank that is executing a payment order of a customer that is not a bank. In this case the customer is the originator. In other cases, the first bank to issue a payment order is not acting for a customer, but is making a payment for its own account. In that event the first bank to issue a payment order is the originator as well as the originator's bank.

2. "Payment order" is defined in Section 4A-103(a)(1) as an instruction to a bank to pay, or to cause another bank to pay, a fixed or determinable amount of money. The bank to which the instruction is addressed is known as the "receiving bank." Section 4A-103(a)(4). "Bank" is defined in Section 4A-105(a)(2). The effect of this definition is to limit Article 4A to payments made through the banking system. A transfer of funds made by an entity outside the banking system is excluded. A transfer of funds through an entity other than a bank is usually a consumer transaction involving relatively small amounts of money and a single contract carried out by transfers of cash or a cash equivalent such as a check. Typically, the transferor delivers cash or a check to the company making the transfer, which agrees to pay a like amount to a person designated by the transferor. Transactions covered by Article 4A typically involve very large amounts of money in which several transactions involving several banks may be necessary to carry out the payment. Payments are normally made by debits or credits to bank accounts. Originators and beneficiaries are almost always business organizations and the transfers are usually made to pay obligations. Moreover, these transactions are frequently done on the basis of very short-term credit granted by the receiving bank to the sender of the payment order. Wholesale wire transfers involve policy questions that are distinct from those involved in consumer-based transactions by nonbanks.

3. Further limitations on the scope of Article 4A are found in the three requirements found in subparagraphs (i), (ii), and (iii) of Section 4A-103(a)(1). Subparagraph (i) states that the instruction to pay is a payment order only if it "does not state a condition to payment to the beneficiary other than time of payment." An instruction to pay a beneficiary sometimes is subject to a requirement that the beneficiary perform some act such as delivery of documents. For example, a New York bank may have issued a letter of credit in favor of X, a California seller of goods to be shipped to the New York bank's customer in New York. The terms of the letter of credit provide for payment to X if documents are presented to prove shipment of the goods. Instead of providing for presentment of the documents to the New York bank, the letter of credit states that they may be presented to a California bank that acts as an agent for payment. The New York bank sends an instruction to the California bank to pay X upon presentation of the required documents. The instruction is not covered by Article 4A because payment to the beneficiary is conditional upon receipt of shipping documents. The function of banks in a funds transfer under Article 4A is comparable to the role of banks in the collection and payment of checks in that it is essentially mechanical in nature. The low price and high speed that characterize funds transfers reflect this fact. Conditions to payment by the California bank other than time of payment impose responsibilities on that bank that go beyond those in Article 4A funds transfers. Although the payment by the New York bank to X under the letter of credit is not covered by Article 4A, if X is paid by the California bank, payment of the obligation of the New York bank to reimburse the California bank could be made by an Article 4A funds transfer. In such a case there is a distinction between the payment by the New York

bank to X under the letter of credit and the payment by the New York bank to the California bank. For example, if the New York bank pays its reimbursement obligation to the California bank by a Fedwire naming the California bank as beneficiary (see Comment 1 to Section 4A-107), payment is made to the California bank rather than to X. That payment is governed by Article 4A and it could be made either before or after payment by the California bank to X. The payment by the New York bank to X under the letter of credit is not governed by Article 4A and it occurs when the California bank, as agent of the New York bank, pays X. No payment order was involved in that transaction. In this example, if the New York bank had erroneously sent an instruction to the California bank unconditionally instructing payment to X, the instruction would have been an Article 4A payment order. If the payment order was accepted (Section 4A-209(b)) by the California bank, a payment by the New York bank to X would have resulted (Section 4A-406(a)). But Article 4A would not prevent recovery of funds from X on the basis that X was not entitled to retain the funds under the law of mistake and restitution, letter of credit law or other applicable law.

4. Transfers of funds made through the banking system are commonly referred to as either "credit" transfers or "debit" transfers. In a credit transfer the instruction to pay is given by the person making payment. In a debit transfer the instruction to pay is given by the person receiving payment. The purpose of subparagraph (ii) of subsection (a)(1) of Section 4A-103 is to include credit transfers in Article 4A and to exclude debit transfers. All of the instructions to pay in the three cases described in Comment 1 fall within subparagraph (ii). Take Case #2 as an example. With respect to X's instruction given to Bank A, Bank A will be reimbursed by debiting X's account or otherwise receiving payment from X. With respect to Bank A's instruction to Bank B, Bank B will be reimbursed by receiving payment from Bank A. In a debit transfer, a creditor, pursuant to authority from the debtor, is enabled to draw on the debtor's bank account by issuing an instruction to pay to the debtor's bank. If the debtor's bank pays, it will be reimbursed by the debtor rather than by the person giving the instruction. For example, the holder of an insurance policy may pay premiums by authorizing the insurance company to order the policyholder's bank to pay the insurance company. The order to pay may be in the form of a draft covered by Article 3, or it might be an instruction to pay that is not an instrument under that Article. The bank receives reimbursement by debiting the policyholder's account. Or, a subsidiary corporation may make payments to its parent by authorizing the parent to order the subsidiary's bank to pay the parent from the subsidiary's account. These transactions are not covered by Article 4A because subparagraph (2) is not satisfied. Article 4A is limited to transactions in which the account to be debited by the receiving bank is that of the person in whose name the instruction is given.

If the beneficiary of a funds transfer is the originator of the transfer, the transfer is governed by Article 4A if it is a credit transfer in form. If it is in the form of a debit transfer it is not governed by Article 4A. For example, Corporation has accounts in Bank A and Bank B. Corporation instructs Bank A to pay to Corporation's account in Bank B. The funds transfer is governed by Article 4A. Sometimes, Corporation will authorize Bank B to draw on Corporation's account in Bank A for the purpose of transferring funds into Corporation's account in Bank B. If Corporation also makes an agreement with Bank A under which Bank A is authorized to follow instructions of Bank B, as agent of Corporation, to transfer funds from Customer's account in Bank A, the instruction of Bank B is a payment order of Customer and is governed by Article 4A. This kind of transaction is known in the wire-transfer business as a "draw-down transfer." If Corporation does not make such an agreement with Bank A and Bank B instructs Bank A to make the transfer, the order is in form a debit transfer and is not governed by Article 4A. These debit transfers are normally ACH transactions in which Bank A relies on Bank B's warranties pursuant to ACH rules, including the warranty that the transfer is authorized.

5. The principal effect of subparagraph (iii) of subsection (a) of Section 4A-103 is to exclude from Article 4A payments made by check or credit card. In those cases the instruction of the debtor to the bank on which the check is drawn or to which the creditcard slip is to be presented is contained in the check

or creditcard slip signed by the debtor. The instruction is not transmitted by the debtor directly to the debtor's bank. Rather, the instruction is delivered or otherwise transmitted by the debtor to the creditor who then presents it to the bank either directly or through bank collection channels. These payments are governed by Articles 3 and 4 and federal law. There are, however, limited instances in which the paper on which a check is printed can be used as the means of transmitting a payment order that is covered by Article 4A. Assume that Originator instructs Originator's Bank to pay $10,000 to the account of Beneficiary in Beneficiary's Bank. Since the amount of Originator's payment order is small, if Originator's Bank and Beneficiary's Bank do not have an account relationship, Originator's Bank may execute Originator's order by issuing a teller's check payable to Beneficiary's Bank for $10,000 along with instructions to credit Beneficiary's account in that amount. The instruction to Beneficiary's Bank to credit Beneficiary's account is a payment order. The check is the means by which Originator's Bank pays its obligation as sender of the payment order. The instruction of Originator's Bank to Beneficiary's Bank might be given in a letter accompanying the check or it may be written on the check itself. In either case the instruction to Beneficiary's Bank is a payment order but the check itself (which is an order to pay addressed to the drawee rather than to Beneficiary's Bank) is an instrument under Article 3 and is not a payment order. The check can be both the means by which Originator's Bank pays its obligation under § 4A-402(b) to Beneficiary's Bank and the means by which the instruction to Beneficiary's Bank is transmitted.

6. Most payments covered by Article 4A are commonly referred to as wire transfers and usually involve some kind of electronic transmission, but the applicability of Article 4A does not depend upon the means used to transmit the instruction of the sender. Transmission may be by letter or other written communication, oral communication or electronic communication. An oral communication is normally given by telephone. Frequently the message is recorded by the receiving bank to provide evidence of the transaction, but apart from problems of proof there is no need to record the oral instruction. Transmission of an instruction may be a direct communication between the sender and the receiving bank or through an intermediary such as an agent of the sender, a communication system such as international cable, or a funds transfer system such as CHIPS, SWIFT or an automated clearing house.

§ 25-4A-105. Other definitions.

(a) In this Article:

(1) "Authorized account" means a deposit account of a customer in a bank designated by the customer as a source of payment of payment orders issued by the customer to the bank. If a customer does not so designate an account, any account of the customer is an authorized account if payment of a payment order from that account is not inconsistent with a restriction on the use of that account.

(2) "Bank" means a person engaged in the business of banking and includes a savings bank, savings and loan association, credit union, and trust company. A branch or separate office of a bank is a separate bank for purposes of this Article.

(3) "Customer" means a person, including a bank, having an account with a bank or from whom a bank has agreed to receive payment orders.

(4) "Funds-transfer business day" of a receiving bank means the part of a day during which the receiving bank is open for the receipt, processing, and transmittal of payment orders and cancellations and amendments of payment orders.

(5) "Funds-transfer system" means a wire transfer network, automated clearinghouse, or other communication system

of a clearinghouse or other association of banks through which a payment order by a bank may be transmitted to the bank to which the order is addressed.

(6) "Good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(7) "Prove" with respect to a fact means to meet the burden of establishing the fact (G.S. 25-1-201(8)).

(b) Other definitions applying to this Article and the sections in which they appear are:

"Acceptance"	G.S. 25-4A-209
"Beneficiary"	G.S. 25-4A-103
"Beneficiary's bank"	G.S. 25-4A-103
"Executed"	G.S. 25-4A-301
"Execution date"	G.S. 25-4A-301
"Funds transfer"	G.S. 25-4A-104
"Funds-transfer system rule"	G.S. 25-4A-501
"Intermediary bank"	G.S. 25-4A-104
"Originator"	G.S. 25-4A-104
"Originator's bank"	G.S. 25-4A-104
"Payment by beneficiary's bank to beneficiary"	G.S. 25-4A-405
"Payment by originator to beneficiary"	G.S. 25-4A-406
"Payment by sender to receiving bank"	G.S. 25-4A-403
"Payment date"	G.S. 25-4A-401
"Payment order"	G.S. 25-4A-103
"Receiving bank"	G.S. 25-4A-103
"Security procedure"	G.S. 25-4A-201
"Sender"	G.S. 25-4A-103.

(c) The following definitions in Article 4 apply to this Article:

"Clearing house"	G.S. 25-4-104
"Item"	G.S. 25-4-104
"Suspends payments"	G.S. 25-4-104.

(d) In addition, Article 1 of this Chapter contains general definitions and principles of construction and interpretation applicable throughout this Article. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. The definition of "bank" in subsection (a)(2) includes some institutions that are not commercial banks. The definition reflects the fact that many financial institutions now perform functions previously restricted to commercial banks, including acting on behalf of customers in funds transfers. Since many funds transfers involve payment orders to or from foreign countries the definition also covers foreign banks. The definition also includes Federal Reserve Banks. Funds transfers carried out by Federal Reserve Banks are described in Comments 1 and 2 to Section 4A-107.

2. Funds transfer business is frequently transacted by banks outside of general banking hours. Thus, the definition of banking day in Section 4-104(1)(c) cannot be used to describe when a bank is open for funds transfer business. Subsection (a)(4) defines a new term, "funds transfer business day," which is applicable to Article 4A. The definition states, "is open for the receipt, processing, and transmittal of payment orders and cancellations and amendments of payment orders." In some cases it is possible to electronically transmit payment orders and other communications to a receiving bank at any time. If the receiving bank is not open for the processing of an order when it is received, the communication is stored in the receiving bank's computer for retrieval when the receiving bank is open for processing. The use of the conjunctive makes clear that the defined term is limited to the period during which all functions of the receiving bank can be performed, i.e., receipt, processing, and transmittal of payment orders, cancellations and amendments.

3. Subsection (a)(5) defines "funds transfer system." The term includes a system such as CHIPS which provides for transmission of a payment order as well as settlement of the obligation of the sender to pay the order. It also includes automated clearing houses, operated by a clearing house or other association of banks, which process and transmit payment orders of banks to other banks. In addition the term includes organizations that provide only transmission services such as SWIFT. The definition also includes the wire transfer network and automated clearing houses of Federal Reserve Banks. Systems of the Federal Reserve Banks, however, are treated differently from systems of other associations of banks. Funds transfer systems other than systems of the Federal Reserve Banks are treated in Article 4A as a means of communication of payment orders between participating banks. Section 4A-206. The Comment to that section and the Comment to Section 4A-107 explain how Federal Reserve Banks function under Article 4A. Funds transfer systems are also able to promulgate rules binding on participating banks that, under Section 4A-501, may supplement or in some cases may even override provisions of Article 4A.

4. Subsection (d) incorporates definitions stated in Article 1 as well as principles of construction and interpretation stated in that Article. Included is Section 1-103. The last paragraph of the Comment to Section 4A-102 is addressed to the issue of the extent to which general principles of law and equity should apply to situations covered by provisions of Article 4A.

§ 25-4A-106. Time payment order is received.

(a) The time of receipt of a payment order or communication cancelling or amending a payment order is determined by the rules applicable to receipt of a notice stated in G.S. 25-1-201(27). A receiving bank may fix a cutoff time or times on a funds-transfer business day for the receipt and processing of payment orders and communications cancelling or amending payment orders. Different cutoff times may apply to payment orders, cancellations, or amendments, or to different categories of payment orders, cancellations, or amendments. A cutoff time may apply to senders generally or different cutoff times may apply to different senders or categories of payment orders. If a payment order or communication cancelling or amending a payment order is received after the close of a funds-transfer business day or after the appropriate cutoff time on a funds-transfer business day, the receiving bank may treat the payment order or communication as received at the opening of the next funds-transfer business day.

(b) If this Article refers to an execution date or payment date or states a day on which a receiving bank is required to take action, and the date or day does not fall on a funds- transfer business day, the next day that is a funds-transfer business day is treated as the date or day stated, unless the contrary is stated in this Article. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

The time that a payment order is received by a receiving bank usually defines the payment date or the execution date of a payment order. Section 4A-401 and Section 4A-301. The time of receipt of a payment order, or communication cancelling or amending a payment order is defined in subsection (a) by reference to the rules stated in Section 1-201(27). Thus, time of receipt is determined by the same rules that determine when a notice is received. Time of receipt, however, may be altered by a cut-off time.

§ 25-4A-107. Federal reserve regulations and operating circulars.

Regulations of the Board of Governors of the Federal Reserve System and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of this Article to the extent of the inconsistency. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. Funds transfers under Article 4A may be made, in whole or in part, by payment orders through a Federal Reserve Bank in what is usually referred to as a transfer by Fedwire. If Bank A, which has an account in Federal Reserve Bank X, wants to pay $1,000,000 to Bank B, which has an account in Federal Reserve Bank Y, Bank A can issue an instruction to Reserve Bank X requesting a debit of $1,000,000 to Bank A's Reserve account and an equal credit to Bank B's Reserve account. Reserve Bank X will debit Bank A's account and will credit the account of Reserve Bank Y. Reserve Bank X will issue an instruction to Reserve Bank Y requesting a debit of $1,000,000 to the account of Reserve Bank X and an equal credit to Bank B's account in Reserve Bank Y. Reserve Bank Y will make the requested debit and credit and will give Bank B an advice of credit. The definition of "bank" in Section 4A-105(a)(2) includes both Reserve Bank X and Reserve Bank Y. Bank A's instruction to Reserve Bank X to pay money to Bank B is a payment order under Section 4A-103(a)(1). Bank A is the sender and Reserve Bank X is the receiving bank. Bank B is the beneficiary of Bank A's order and of the funds transfer. Bank A is the originator of the funds transfer and is also the originator's bank. Section 4A-104(c) and (d). Reserve Bank X, an intermediary bank under Section 4A-104(b), executes Bank A's order by sending a payment order to Reserve Bank Y instructing that bank to credit the Federal Reserve account of Bank B. Reserve Bank Y is the beneficiary's bank.

Suppose the transfer of funds from Bank A to Bank B is part of a larger transaction in which Originator, a customer of Bank A, wants to pay Beneficiary, a customer of Bank B. Originator issues a payment order to Bank A to pay $1,000,000 to the account of Beneficiary in Bank B. Bank A may execute Originator's order by means of Fedwire which simultaneously transfers $1,000,000 from Bank A to Bank B and carries a message instructing Bank B to pay $1,000,000 to the account of Y. The Fedwire transfer is carried out as described in the previous paragraph, except that the beneficiary of the funds transfer is Beneficiary rather than Bank B. Reserve Bank X and Reserve Bank Y are intermediary banks. When Reserve Bank Y advises Bank B of the credit to its Federal Reserve account it will also instruct Bank B to pay to the account of Beneficiary. The instruction is a payment order to Bank B which is the beneficiary's bank. When Reserve Bank Y advises Bank B of the credit to its Federal Reserve account Bank B receives payment of the payment order issued to it by Reserve Bank Y. Section 4A-403(a)(1). The payment order is automatically accepted by Bank B at the time it receives the payment order of Reserve Bank Y. Section 4A-209(b)(2). At the time of acceptance by Bank B payment by Originator to Beneficiary also occurs. Thus, in a Fedwire transfer, payment to the beneficiary's bank, acceptance by the beneficiary's bank and payment by the originator to the beneficiary all occur simultaneously by operation of law at the time the payment order to the beneficiary's bank is received.

If originator orders payment to the account of Beneficiary in Bank C rather than Bank B, the analysis is somewhat modified. Bank A may not have any relationship with Bank C and may not be able to make payment directly to Bank C. In that case, Bank A could send a Fedwire instructing Bank B to instruct Bank C to pay Beneficiary. The analysis is the same as the previous case except that Bank B is an intermediary bank and Bank C is the beneficiary's bank.

2. A funds transfer can also be made through a Federal Reserve Bank in an automated clearing house transaction. In a typical case, Originator instructs Originator's Bank to pay to the account of Beneficiary in Beneficiary's Bank.

Originator's instruction to pay a particular beneficiary is transmitted to Originator's Bank along with many other instructions for payment to other beneficiaries by many different beneficiary's banks. All of these instructions are contained in a magnetic tape or other electronic device. Transmission of instructions to the various beneficiary's banks requires that Originator's instructions be processed and repackaged with instructions of other originators so that all instructions to a particular beneficiary's bank are transmitted together to that bank. The repackaging is done in processing centers usually referred to as automated clearing houses. Automated clearing houses are operated either by Federal Reserve Banks or by other associations of banks. If Originator's Bank chooses to execute Originator's instructions by transmitting them to a Federal Reserve Bank for processing by the Federal Reserve Bank, the transmission to the Federal Reserve Bank results in the issuance of payment orders by Originator's Bank to the Federal Reserve Bank, which is an intermediary bank. Processing by the Federal Reserve Bank will result in the issuance of payment orders by the Federal Reserve Bank to Beneficiary's Bank as well as payment orders to other beneficiary's banks making payments to carry out Originator's instructions.

3. Although the terms of Article 4A apply to funds transfers involving Federal Reserve Banks, federal preemption would make ineffective any Article 4A provision that conflicts with federal law. The payments activities of the Federal Reserve Banks are governed by regulations of the Federal Reserve Board and by operating circulars issued by the Reserve Banks themselves. In some instances, the operating circulars are issued pursuant to a Federal Reserve Board regulation. In other cases, the Reserve Bank issues the operating circular under its own authority under the Federal Reserve Act, subject to review by the Federal Reserve Board. Section 4A-107 states that Federal Reserve Board regulations and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of Article 4A to the extent of the inconsistency. Federal Reserve Board regulations, being valid exercises of regulatory authority pursuant to a federal statute, take precedence over state law if there is an inconsistency. Childs v. Federal Reserve Bank of Dallas, 719 F.2d 812 (5th Cir. 1983), reh. den. 724 F.2d 127 (5th Cir. 1984). Section 4A-107 treats operating circulars as having the same effect whether issued under the Reserve Bank's own authority or under a Federal Reserve Board regulation.

§ 25-4A-108. Exclusion of consumer transactions governed by federal law.

This Article does not apply to a funds transfer any part of which is governed by the Electronic Fund Transfer Act of 1978 (Title XX, Public Law 95-630, 92 Stat. 3728, 15 U.S.C. § 1693 et seq.) as amended from time to time. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

The Electronic Fund Transfer Act of 1978 is a federal statute that covers a wide variety of electronic funds transfers involving consumers. The types of transfers covered by the federal statute are essentially different from the wholesale wire transfers that are the primary focus of Article 4A. Section 4A-108 excludes a funds transfer from Article 4A if any part of the transfer is covered by the federal law. Existing procedures designed to comply with federal law will not be affected by Article 4A. The effect of Section 4A-108 is to make Article 4A and EFTA mutually exclusive. For example, if a funds transfer is to a consumer account in the beneficiary's bank and the funds transfer is made in part by use of Fedwire and in part by means of an automated clearing house, EFTA applies to the ACH part of the transfer but not to the Fedwire part. Under Section 4A-108, Article 4A does not apply to any part of the transfer. However, in the absence of any law to govern the part of the funds transfer that is not subject to EFTA, a court might apply appropriate principles from Article 4A by analogy.

PART 2.

ISSUE AND ACCEPTANCE OF PAYMENT ORDER.

§ 25-4A-201. Security procedure.

"Security procedure" means a procedure established by agreement of a customer and a receiving bank for the purpose of (i) verifying that a payment order or communication amending or cancelling a payment order is that of the customer, or (ii) detecting error in the transmission or the content of the payment order or communication. A security procedure may require the use of algorithms or other codes, identifying words or numbers, encryption, call-back procedures, or similar security devices. Comparison of a signature on a payment order or communication with an authorized specimen signature of the customer is not by itself a security procedure. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

A large percentage of payment orders and communications amending or cancelling payment orders are transmitted electronically and it is standard practice to use security procedures that are designed to assure the authenticity of the message. Security procedures can also be used to detect error in the content of messages or to detect payment orders that are transmitted by mistake as in the case of multiple transmission of the same payment order. Security procedures might also apply to communications that are transmitted by telephone or in writing. Section 4A-201 defines these security procedures. The definition of security procedure limits the term of a procedure "established by agreement of a customer and a receiving bank." The term does not apply to procedures that the receiving bank may follow unilaterally in processing payment orders. The question of whether loss that may result from the transmission of a spurious or erroneous payment order will be borne by the receiving bank or the sender or purported sender is affected by whether a security procedure was or was not in effect and whether there was or was not compliance with the procedure. Security procedures are referred to in Sections 4A-202 and 4A-203, which deal with authorized and verified payment orders, and Section 4A-205, which deals with erroneous payment orders.

§ 25-4A-202. Authorized and verified payment orders.

(a) A payment order received by the receiving bank is the authorized order of the person identified as sender if that person authorized the order or is otherwise bound by it under the law of agency.

(b) If a bank and its customer have agreed that the authenticity of payment orders issued to the bank in the name of the customer as sender will be verified pursuant to a security procedure, a payment order received by the receiving bank is effective as the order of the customer, whether or not authorized, if (i) the security procedure is a commercially reasonable method of providing security against unauthorized payment orders, and (ii) the bank proves that it accepted the payment order in good faith and in compliance with the security procedure and any written agreement or instruction of the customer restricting acceptance of payment orders issued in the name of the customer. The bank is not required to follow an instruction that violates a written agreement with the customer or notice of which is not received at a time and in a manner affording the bank a reasonable opportunity to act on it before the payment order is accepted.

(c) Commercial reasonableness of a security procedure is a question of law to be determined by considering the wishes of the customer expressed to the bank, the circumstances of the customer known to the bank, including the size, type, and frequency of payment orders normally issued by the customer to the bank, alternative security procedures offered to the customer, and security procedures in general use by customers and receiving banks similarly situated. A security procedure is deemed to be commercially reasonable if (i) the security procedure was chosen by the customer after the bank offered, and the customer refused, a security procedure that was commercially reasonable for that customer, and (ii) the customer expressly agreed in writing to be bound by any payment order, whether or not authorized, issued in its name and accepted by the bank in compliance with the security procedure chosen by the customer.

(d) The term "sender" in this Article includes the customer in whose name a payment order is issued if the order is the authorized order of the customer under subsection (a), or it is effective as the order of the customer under subsection (b).

(e) This section applies to amendments and cancellations of payment orders to the same extent it applies to payment orders.

(f) Except as provided in this section and in G.S. 25-4A-203(a)(1), rights and obligations arising under this section or G.S. 25-4A-203 may not be varied by agreement. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

This section is discussed in the Comment following Section 4A-203.

§ 25-4A-203. Unenforceability of certain verified payment orders.

(a) If an accepted payment order is not, under G.S. 25-4A-202(a), an authorized order of a customer identified as sender, but is effective as an order of the customer pursuant to G.S. 25-4A-202(b), the following rules apply:

(1) By express written agreement, the receiving bank may limit the extent to which it is entitled to enforce or retain payment of the payment order.

(2) The receiving bank is not entitled to enforce or retain payment of the payment order if the customer proves that the order was not caused, directly or indirectly, by a person (i) entrusted at any time with duties to act for the customer with respect to payment orders or the security procedure, or (ii) who obtained access to transmitting facilities of the customer or who obtained, from a source controlled by the customer and without authority of the receiving bank, information facilitating breach of the security procedure, regardless of how the information was obtained or whether the customer was at fault. Information includes any access device, computer software, or the like.

(b) This section applies to amendments of payment orders to the same extent it applies to payment orders. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. Some person will always be identified as the sender of a payment order. Acceptance of the order by the receiving bank is based on a belief by the bank that the order was authorized by the person identified as the sender. If the receiving bank is the beneficiary's bank acceptance means that the receiving bank is obliged to pay the beneficiary. If the receiving bank is not the beneficiary's bank, acceptance means that the receiving bank has executed the sender's order and is obliged to pay the bank that accepted the order issued in execution of the sender's order. In either case the receiving bank may suffer a loss unless it is entitled to enforce payment of the payment order that it accepted. If the person identified as the sender of the order refuses to pay on the ground that the order was not authorized by that person, what are the rights of the receiving bank? In the absence of a statute or agreement that specifically addresses the issue, the question usually will be resolved by the law of agency. In some cases, the law of agency works well. For example, suppose the receiving bank executes a payment order given by means of a letter apparently written by a corporation that is a customer of the bank and apparently signed by an officer of the corporation. If the receiving bank acts solely on the basis of the letter, the corporation is not bound as the sender of the payment order unless the signature was that of the officer and the officer was authorized to act for the corporation in the issuance of payment orders, or some other agency doctrine such as apparent authority or estoppel causes the corporation to be bound. Estoppel can be illustrated by the following example. Suppose P is aware that A, who is unauthorized to act for P, has fraudulently misrepresented to T that A is authorized to act for P. T believes A and is about to rely on the misrepresentation. If P does not notify T of the true facts although P could easily do so, P may be estopped from denying A's lack of authority. A similar result could follow if the failure to notify T is the result of negligence rather than a deliberate decision. Restatement, Second, Agency § 8B. Other equitable principles such as subrogation or restitution might also allow a receiving bank to recover with respect to an unauthorized payment order that it accepted. In Gatoil (U.S.A.), Inc. v. Forest Hill State Bank, 1 U.C.C. Rep. Serv. 2d 171 (D. Md. 1986), a joint venturer not authorized to order payments from the account of the joint venture, ordered a funds transfer from the account. The transfer paid a bona fide debt of the joint venture. Although the transfer was unauthorized the court refused to require recredit of the account because the joint venture suffered no loss. The result can be rationalized on the basis of subrogation of the receiving bank to the right of the beneficiary of the funds transfer to receive the payment from the joint venture.

But in most cases these legal principles give the receiving bank very little protection in the case of an authorized payment order. Cases like those just discussed are not typical of the way that most payment orders are transmitted and accepted, and such cases are likely to become even less common. Given the large amount of the typical payment order, a prudent receiving bank will be unwilling to accept a payment order unless it has assurance that the order is what it purports to be. This assurance is normally provided by security procedures described in Section 4A-201.

In a very large percentage of cases covered by Article 4A, transmission of the payment order is made electronically. The receiving bank may be required to act on the basis of a message that appears on a computer screen. Common law concepts of authority of agent to bind principal are not helpful. There is no way of determining the identity or the authority of the person who caused the message to be sent. The receiving bank is not relying on the authority of any particular person to act for the purported sender. The case is not comparable to payment of a check by the drawee bank on the basis of a signature that is forged. Rather, the receiving bank relies on a security procedure pursuant to which the authenticity of the message can be "tested" by various devices which are designed to provide certainty that the message is that of the sender identified in the payment order. In the wire transfer business the concept of "authorized" is different from that found in agency law. In that business a payment order is treated as the order of the person in whose name it is issued if it is properly tested pursuant to a security procedure and the order passes the test.

Section 4A-202 reflects the reality of the wire transfer business. A person in whose name a payment order is issued is considered to be the sender of the order if the order is "authorized" as stated in subsection (a) or if the order is "verified" pursuant to a security procedure in compliance with subsection (b). If subsection (b) does not apply, the question of whether the customer is responsible for the order is determined by the law of agency. The issue is one of actual or apparent authority of the person who caused the order to be issued in the name of the customer. In some cases the law of agency might allow the customer to be bound by an unauthorized order if conduct of the customer can be used to find an estoppel against the customer to deny that the order was unauthorized. If the customer is bound by the order under any of these agency doctrines, subsection (a) treats the order as authorized and thus the customer is deemed to be the sender of the order. In most cases, however, subsection (b) will apply. In that event there is no need to make an agency law analysis to determine authority. Under Section 4A-202, the issue of liability of the purported sender of the payment order will be determined by agency law only if the receiving bank did not comply with subsection (b).

2. The scope of Section 4A-202 can be illustrated by the following cases.

Case #1. A payment order purporting to be that of Customer is received by Receiving Bank but the order was fraudulently transmitted by a person who had no authority to act for Customer.

Case #2. An authentic payment order was sent by Customer, but before the order was received by Receiving Bank the order was fraudulently altered by an unauthorized person to change the beneficiary.

Case #3. An authentic payment order was received by Receiving Bank, but before the order was executed by Receiving Bank a person who had no authority to act for Customer fraudulently sent a communication purporting to amend the order by changing the beneficiary.

In each case Receiving Bank acted on the fraudulent communication by accepting the payment order. These cases are all essentially similar and they are treated identically by Section 4A-202. In each case Receiving Bank acted on a communication that it thought was authorized by Customer when in fact the communication was fraudulent. No distinction is made between Case #1 in which Customer took no part at all in the transaction and Case #2 and Case #3 in which an authentic order was fraudulently altered or amended by an unauthorized person. If subsection (b) does not apply, each case is governed by subsection (a). If there are no additional facts on which an estoppel might be found, Customer is not responsible in Case #1 for the fraudulently issued payment order, in Case #2 for the fraudulent alteration or in Case #3 for the fraudulent amendment. Thus, in each case Customer is not liable to pay the order and Receiving Bank takes the loss. The only remedy of Receiving Bank is to seek recovery from the person who received payment as beneficiary of the fraudulent order. If there was verification in compliance with subsection (b), Customer will take the loss unless Section 4A-203 applies.

3. Subsection (b) of Section 4A-202 is based on the assumption that losses due to fraudulent payment orders can best be avoided by the use of commercially reasonable security procedures, and that the use of such procedures should be encouraged. The subsection is designed to protect both the customer and the receiving bank. A receiving bank needs to be able to rely on objective criteria to determine whether it can safely act on a payment order. Employees of the bank can be trained to "test" a payment order according to the various steps specified in the security procedure. The bank is responsible for the acts of these employees. Subsection (b)(ii) requires the bank to prove that it accepted the payment order in good faith and "in compliance with the security procedure." If the fraud was not detected because the bank's employee did not perform the acts required by the security procedure, the bank has not complied. Subsection (b)(ii) also requires the bank to prove that it complied with any agreement or instruction that restricts acceptance of payment orders issued in the name of the customer. A customer may want to protect itself by imposing limitations on acceptance of payment orders by the

bank. For example, the customer may prohibit the bank from accepting a payment order that is not payable from an authorized account, that exceeds the credit balance in specified accounts of the customer, or that exceeds some other amount. Another limitation may relate to the beneficiary. The customer may provide the bank with a list of authorized beneficiaries and prohibit acceptance of any payment order to a beneficiary not appearing on the list. Such limitations may be incorporated into the security procedure itself or they may be covered by a separate agreement or instruction. In either case, the bank must comply with the limitations if the conditions stated in subsection (b) are met. Normally limitations on acceptance would be incorporated into an agreement between the customer and the receiving bank, but in some cases the instruction might be unilaterally given by the customer. If standing instructions or an agreement state limitations on the ability of the receiving bank to act, provision must be made for later modification of the limitations. Normally this would be done by an agreement that specifies particular procedures to be followed. Thus, subsection (b) states that the receiving bank is not required to follow an instruction that violates a written agreement. The receiving bank is not bound by an instruction unless it has adequate notice of it. Subsections (25), (26) and (27) of Section 1-201 apply.

Subsection (b)(i) assures that the interests of the customer will be protected by providing an incentive to a bank to make available to the customer a security procedure that is commercially reasonable. If a commercially reasonable security procedure is not made available to the customer, subsection (b) does not apply. The result is that subsection (a) applies and the bank acts at its peril in accepting a payment order that may be unauthorized. Prudent banking practice may require that security procedures be utilized in virtually all cases except for those in which personal contact between the customer and the bank eliminates the possibility of an unauthorized order. The burden of making available commercially reasonable security procedures is imposed on receiving banks because they generally determine what security procedures can be used and are in the best position to evaluate the efficacy of the procedures offered to customers to combat fraud. The burden on the customer is to supervise its employees to assure compliance with the security procedure and to safeguard confidential security information and access to transmitting facilities so that the security procedure cannot be breached.

4. The principal issue that is likely to arise in litigation involving subsection (b) is whether the security procedure in effect when a fraudulent payment order was accepted was commercially reasonable. The concept of what is commercially reasonable in a given case is flexible. Verification entails labor and equipment costs that can vary greatly depending upon the degree of security that is sought. A customer that transmits very large numbers of payment orders in very large amounts may desire and may reasonably expect to be provided with state-of-the-art procedures that provide maximum security. But the expense involved may make use of a state-of-the-art procedure infeasible for a customer that normally transmits payment orders infrequently or in relatively low amounts. Another variable is the type of receiving bank. It is reasonable to require large money center banks to make available state-of-the-art security procedures. On the other hand, the same requirement may not be reasonable for a small country bank. A receiving bank might have several security procedures that are designed to meet the varying needs of different customers. The type of payment order is another variable. For example, in a wholesale wire transfer, each payment order is normally transmitted electronically and individually. A testing procedure will be individually applied to each payment order. In funds transfers to be made by means of an automated clearing house many payment orders are incorporated into an electronic device such as a magnetic tape that is physically delivered. Testing of the individual payment orders is not feasible. Thus, a different kind of security procedure must be adopted to take into account the different mode of transmission.

The issue of whether a particular security procedure is commercially reasonable is a question of law. Whether the receiving bank complied with the procedure is a question of fact. It is appropriate to make the finding concerning commercial reasonability a matter of law because security procedures are likely to be standardized in the banking industry and a question of law standard leads to more predictability concerning the level of security that a bank must offer to its customers. The purpose of subsection (b) is to encourage banks to institute reasonable safeguards against fraud but not to make them insurers against fraud. A security procedure is not commercially unreasonable simply because another procedure might have been better or because the judge deciding the question would have opted for a more stringent procedure. The standard is not whether the security procedure is the best available. Rather it is whether the procedure is reasonable for the particular customer and the particular bank, which is a lower standard. On the other hand, a security procedure that fails to meet prevailing standards of good banking practice applicable to the particular bank should not be held to be commercially reasonable. Subsection (c) states factors to be considered by the judge in making the determination of commercial reasonableness. Sometimes an informed customer refuses a security procedure that is commercially reasonable and suitable for that customer and insists on using a higher-risk procedure because it is more convenient or cheaper. In that case, under the last sentence of subsection (c), the customer has voluntarily assumed the risk of failure of the procedure and cannot shift the loss to the bank. But this result follows only if the customer expressly agrees in writing to assume that risk. It is implicit in the last sentence of subsection (c) that a bank that accedes to the wishes of its customer in this regard is not acting in bad faith by so doing so long as the customer is made aware of the risk. In all cases, however, a receiving bank cannot get the benefit of subsection (b) unless it has made available to the customer a security procedure that is commercially reasonable and suitable for use by that customer. In most cases, the mutual interest of bank and customer to protect against fraud should lead to agreement to a security procedure which is commercially reasonable.

5. The effect of Section 4A-202(b) is to place the risk of loss on the customer if an unauthorized payment order is accepted by the receiving bank after verification by the bank in compliance with a commercially reasonable security procedure. An exception to this result is provided by Section 4A-203(a)(2). The customer may avoid the loss resulting from such a payment order if the customer can prove that the fraud was not committed by a person described in that subsection. Breach of a commercially reasonable security procedure requires that the person committing the fraud have knowledge of how the procedure works and knowledge of codes, identifying devices, and the like. That person may also need access to transmitting facilities through an access device or other software in order to breach the security procedure. This confidential information must be obtained either from a source controlled by the customer or from a source controlled by the receiving bank. If the customer can prove that the person committing the fraud did not obtain the confidential information from an agent or former agent of the customer or from a source controlled by the customer, the loss is shifted to the bank. "Prove" is defined in Section 4A-105(a)(7). Because of bank regulation requirements, in this kind of case there will always be a criminal investigation as well as an internal investigation of the bank to determine the probable explanation for the breach of security. Because a funds transfer fraud usually will involve a very large amount of money, both the criminal investigation and the internal investigation are likely to be thorough. In some cases there may be an investigation by bank examiners as well. Frequently, these investigations will develop evidence of who is at fault and the cause of the loss. The customer will have access to evidence developed in these investigations and that evidence can be used by the customer in meeting its burden of proof.

6. The effect of Section 4A-202(b) may also be changed by an agreement meeting the requirements of Section 4A-203(a)(1). Some customers may be unwilling to take all or part of the risk of loss with respect to unauthorized payment orders even if all of the requirements of Section 4A-202(b) are met. By virtue of Section 4A-203(a)(1), a receiving bank may assume all of the risk of loss with respect to unauthorized payment orders or the customer and bank may agree that losses from unauthorized payment orders are to be divided as provided in the agreement.

7. In a large majority of cases the sender of a payment order is a bank. In many cases in which there is a bank sender, both the sender and the receiving bank will be members of a funds transfer system over which the payment order is transmitted. Since Section

4A-202(f) does not prohibit a funds transfer system rule from varying rights and obligations under Section 4A-202, a rule of the funds transfer system can determine how loss due to an unauthorized payment order from a participating bank to another participating bank is to be allocated. A funds transfer system rule, however, cannot change the rights of a customer that is not a participating bank. § 4A-501(b). Section 4A-202(f) also prevents variation by agreement except to the extent stated.

§ 25-4A-204. Refund of payment and duty of customer to report with respect to unauthorized payment order.

(a) If a receiving bank accepts a payment order issued in the name of its customer as sender which is (i) not authorized and not effective as the order of the customer under G.S. 25-4A-202, or (ii) not enforceable, in whole or in part, against the customer under G.S. 25-4A-203, the bank shall refund any payment of the payment order received from the customer to the extent the bank is not entitled to enforce payment and shall pay interest on the refundable amount calculated from the date the bank received payment to the date of the refund. However, the customer is not entitled to interest from the bank on the amount to be refunded if the customer fails to exercise ordinary care to determine that the order was not authorized by the customer and to notify the bank of the relevant facts within a reasonable time not exceeding 90 days after the date the customer received notification from the bank that the order was accepted or that the customer's account was debited with respect to the order. The bank is not entitled to any recovery from the customer on account of a failure by the customer to give notification as stated in this section.

(b) Reasonable time under subsection (a) may be fixed by agreement as stated in G.S. 25-1-204(1), but the obligation of a receiving bank to refund payment as stated in subsection (a) may not otherwise be varied by agreement. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. With respect to unauthorized payment orders, in a very large percentage of cases a commercially reasonable security procedure will be in effect. Section 4A-204 applies only to cases in which (i) no commercially reasonable security procedure is in effect, (ii) the bank did not comply with a commercially reasonable security procedure that was in effect, (iii) the sender can prove, pursuant to Section 4A-203(a)(2), that the culprit did not obtain confidential security information controlled by the customer, or (iv) the bank, pursuant to Section 4A-203(a)(1) agreed to take all or part of the loss resulting from an unauthorized payment order. In each of these cases the bank takes the risk of loss with respect to an unauthorized payment order because the bank is not entitled to payment from the customer with respect to the order. The bank normally debits the customer's account or otherwise receives payment from the customer shortly after acceptance of the payment order. Subsection (a) of Section 4A-204 states that the bank must recredit the account or refund payment to the extent the bank is not entitled to enforce payment.

2. Section 4A-204 is designed to encourage a customer to promptly notify the receiving bank that it has accepted an unauthorized payment order. Since cases of unauthorized payment orders will almost always involve fraud, the bank's remedy is normally to recover from the beneficiary of the unauthorized order if the beneficiary was party to the fraud. This remedy may not be worth very much and it may not make any difference whether or not the bank promptly learns about the fraud. But in

some cases prompt notification may make it easier for the bank to recover some part of its loss from the culprit. The customer will routinely be notified of the debit to its account with respect to an unauthorized order or will otherwise be notified of acceptance of the order. The customer has a duty to exercise ordinary care to determine that the order was unauthorized after it has received notification from the bank, and to advise the bank of the relevant facts within a reasonable time not exceeding 90 days after receipt of notification. Reasonable time is not defined and it may depend on the facts of the particular case. If a payment order for $1,000,000 is wholly unauthorized, the customer should normally discover it in far less than 90 days. If a $1,000,000 payment order was authorized but the name of the beneficiary was fraudulently changed, a much longer period may be necessary to discover the fraud. But in any event, if the customer delays more than 90 days the customer's duty has not been met. The only consequence of a failure of the customer to perform this duty is a loss of interest on the refund payable by the bank. A customer that acts promptly is entitled to interest from the time the customer's account was debited or the customer otherwise made payment. The rate of interest is stated in Section 4A-506. If the customer fails to perform the duty, no interest is recoverable for any part of the period before the bank learns that it accepted an unauthorized order. But the bank is not entitled to any recovery from the customer based on negligence for failure to inform the bank. Loss of interest is in the nature of a penalty on the customer designed to provide an incentive for the customer to police its account. There is no intention to impose a duty on the customer that might result in shifting loss from the unauthorized order to the customer.

§ 25-4A-205. Erroneous payment orders.

(a) If an accepted payment order was transmitted pursuant to a security procedure for the detection of error and the payment order (i) erroneously instructed payment to a beneficiary not intended by the sender, (ii) erroneously instructed payment in an amount greater than the amount intended by the sender, or (iii) was an erroneously transmitted duplicate of a payment order previously sent by the sender, the following rules apply:

(1) If the sender proves that the sender or a person acting on behalf of the sender pursuant to G.S. 25-4A-206 complied with the security procedure and that the error would have been detected if the receiving bank had also complied, the sender is not obliged to pay the order to the extent stated in paragraphs (2) and (3).

(2) If the funds transfer is completed on the basis of an erroneous payment order described in clause (i) or (iii) of subsection (a), the sender is not obliged to pay the order and the receiving bank is entitled to recover from the beneficiary any amount paid to the beneficiary to the extent allowed by the law governing mistake and restitution.

(3) If the funds transfer is completed on the basis of a payment order described in clause (ii) of subsection (a), the sender is not obliged to pay the order to the extent the amount received by the beneficiary is greater than the amount intended by the sender. In that case, the receiving bank is entitled to recover from the beneficiary the excess amount received to the extent allowed by the law governing mistake and restitution.

(b) If (i) the sender of an erroneous payment order described in subsection (a) is not obliged to pay all or part of the order, and (ii) the sender receives notification from the receiving bank that the order was accepted by the bank or that the sender's account was debited with respect to the order, the sender has a duty to exercise ordinary care, on the basis of information available to the sender, to discover the error with respect to the order and to advise the bank of the relevant facts within a reasonable time, not exceeding 90 days, after the bank's notification was received by the sender. If the bank proves that the sender failed to perform that duty, the sender is liable to the bank for the loss the bank proves it incurred as a result of the failure, but the liability of the sender may not exceed the amount of the sender's order.

(c) This section applies to amendments to payment orders to the same extent it applies to payment orders. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. This section concerns error in the content or in the transmission of payment orders. It deals with three kinds of error. *Case #1.* The order identifies a beneficiary not intended by the sender. For example, Sender intends to wire funds to a beneficiary identified only by an account number. The wrong account number is stated in the order. *Case #2.* The error is in the amount of the order. For example, Sender intends to wire $1,000 to Beneficiary. Through error, the payment order instructs payment of $1,000,000. *Case #3.* A payment order is sent to the receiving bank and then, by mistake, the same payment order is sent to the receiving bank again. In Case #3, the receiving bank may have no way of knowing whether the second order is a duplicate of the first or is another order. Similarly, in Case #1 and Case #2, the receiving bank may have no way of knowing that the error exists. In each case, if this section does not apply and the funds transfer is completed, Sender is obliged to pay the order. Section 4A-402. Sender's remedy, based on payment by mistake, is to recover from the beneficiary that received payment.

Sometimes, however, transmission of payment orders of the sender to the receiving bank is made pursuant to a security procedure designed to detect one or more of the errors described above. Since "security procedure" is defined by Section 4A-201 as "a procedure established by agreement of a customer and a receiving bank for the purpose of * * * detecting error * * *," Section 4A-205 does not apply if the receiving bank and the customer did not agree to the establishment of a procedure for detecting error. A security procedure may be designed to detect an account number that is not one to which Sender normally makes payment. In that case, the security procedure may require a special verification that payment to the stated account number was intended. In the case of dollar amounts, the security procedure may require different codes for different dollar amounts. If a $1,000,000 payment order contains a code that is inappropriate for that amount, the error in amount should be detected. In the case of duplicate orders, the security procedure may require that each payment order be identified by a number or code that applies to no other order. If the number or code of each payment order received is registered in a computer base, the receiving bank can quickly identify a duplicate order. The three cases covered by this section are essentially similar. In each, if the error is not detected, some beneficiary will receive funds that the beneficiary was not intended to receive. If this section applies, the risk of loss with respect to the error of the sender is shifted to the bank which has the burden of recovering the funds from the beneficiary. The risk of loss is shifted to the bank only if the sender proves that the error would have been detected if there had been compliance with the procedure and that the sender (or an agent under Section 4A-206) complied. In the case of a duplicate order or a wrong beneficiary, the sender doesn't have to pay the order. In the case of an overpayment, the sender does not have to pay the order to the extent of the overpayment. If subsection (a)(1) applies, the position of the receiving bank is comparable to that of a receiving bank that erroneously executes a payment order as stated in Section 4A-303. However, failure of the sender to timely report the error is covered by Section 4A-205(b) rather than by Section 4A-304 which applies only to erroneous execution under Section 4A-303. A receiving bank to which the risk of loss is shifted by subsection (a)(1) or (2) is entitled to recover the amount erroneously paid to the beneficiary to the extent allowed by the law of mistake and restitution. Rights of the receiving bank against the beneficiary are similar to those of a receiving bank that erroneously executes a payment order as stated in Section 4A-303. Those rights are discussed in Comment 2 to Section 4A-303.

2. A security procedure established for the purpose of detecting error is not effective unless both sender and receiving bank comply with the procedure. Thus, the bank undertakes a duty of complying with the procedure for the benefit of the sender. This duty is recognized in subsection (a)(1). The loss with respect to the sender's error is shifted to the bank if the bank fails to comply with the procedure and the sender (or an agent under Section 4A-206) does comply. Although the customer may have been negligent in transmitting the erroneous payment order, the loss is put on the bank on a last-clear-chance theory. A similar analysis applies to subsection (b). If the loss with respect to an error is shifted to the receiving bank and the sender is notified by the bank that the erroneous payment order was accepted, the sender has a duty to exercise ordinary care to discover the error and notify the bank of the relevant facts within a reasonable time not exceeding 90 days. If the bank can prove that the sender failed in this duty it is entitled to compensation for the loss incurred as a result of the failure. Whether the bank is entitled to recover from the sender depends upon whether the failure to give timely notice would have made any difference. If the bank could not have recovered from the beneficiary that received payment under the erroneous payment order even if timely notice had been given, the sender's failure to notify did not cause any loss of the bank.

3. Section 4A-205 is subject to variation by agreement under Section 4A-501. Thus, if a receiving bank and its customer have agreed to a security procedure for detection of error, the liability of the receiving bank for failing to detect an error of the customer as provided in Section 4A-205 may be varied as provided in an agreement of the bank and the customer.

§ 25-4A-206. Transmission of payment order through funds-transfer or other communication system.

(a) If a payment order addressed to a receiving bank is transmitted to a funds-transfer system or other third-party communication system for transmittal to the bank, the system is deemed to be an agent of the sender for the purpose of transmitting the payment order to the bank. If there is a discrepancy between the terms of the payment order transmitted to the system and the terms of the payment order transmitted by the system to the bank, the terms of the payment order of the sender are those transmitted by the system. This section does not apply to a funds-transfer system of the Federal Reserve Banks.

(b) This section applies to cancellations and amendments of payment orders to the same extent it applies to payment orders. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. A payment order may be issued to a receiving bank directly by delivery of a writing or electronic device or by an oral or electronic communication. If an agent of the sender is employed to transmit orders on behalf of the sender, the sender is bound by the order transmitted by the agent on the basis of agency law. Section 4A-206 is an application of that principle to cases in which a funds transfer or communication system acts as an intermediary in transmitting the sender's order to the receiving bank. The intermediary is deemed to be an agent of the sender for the purpose of transmitting payment orders and related messages for the sender. Section 4A-206 deals with error by the intermediary.

2. Transmission by an automated clearing house of an association of banks other than the Federal Reserve Banks is an example of a transaction covered by Section 4A-206. Suppose Originator orders Originator's Bank to cause a large number of payments to be made to many accounts in banks in various parts of the country. These payment orders are electronically transmitted to Originator's Bank and stored in an electronic device that is held by Originator's Bank. Or, transmission of the various payment orders is made by delivery to Originator's Bank of an electronic device containing the instruction to the bank. In either case the terms of the various payment orders by Originator are determined by the information contained in the electronic device. In order to execute the various orders, the information in the electronic device must be processed. For example, if some of the orders are for payments to accounts in Bank X and some to accounts in Bank Y, Originator's Bank will execute these orders of Originator by issuing a series of payment orders to Bank X covering all payments to accounts in that bank, and by issuing a series of payment orders to Bank Y covering all payments to accounts in that bank. The orders to Bank X may be transmitted together by means of an electronic device, and those to Bank Y may be included in another electronic device. Typically, this processing is done by an automated clearing house acting for a group of banks including Originator's Bank. The automated clearing house is a funds transfer system. Section 4A-105(a)(5). Originator's Bank delivers Originator's electronic device or transmits the information contained in the device to the funds transfer system for processing into payment orders of Originator's Bank to the appropriate beneficiary's banks. The processing may result in an erroneous payment order. Originator's Bank, by use of Originator's electronic device, may have given information to the funds transfer system instructing payment of $100,000 to an account in Bank X, but because of human error or an equipment malfunction the processing may have converted that instruction into an instruction to Bank X to make a payment of $1,000,000. Under Section 4A-206, Originator's Bank issued a payment order for $1,000,000 to Bank X when the erroneous information was sent to Bank X. Originator's Bank is responsible for the error of the automated clearing house. The liability of the funds transfer system that made the error is not governed by Article 4A. It is left to the law of contract, a funds transfer system rule, or other applicable law.

In the hypothetical case just discussed, if the automated clearing house is operated by a Federal Reserve Bank, the analysis is different. Section 4A-206 does not apply. Originator's Bank will execute Originator's payment orders by delivery or transmission of the electronic information to the Federal Reserve Bank for processing. The result is that Originator's Bank has issued payment orders to the Federal Reserve Bank which, in this case, is acting as an intermediary bank. When the Federal Reserve Bank has processed the information given to it by Originator's Bank it will issue payment orders to the various beneficiary's banks. If the processing results in an erroneous payment order, the Federal Reserve Bank has erroneously executed the payment order of Originator's Bank and the case is governed by Section 4A-303.

§ 25-4A-207. Misdescription of beneficiary.

(a) Subject to subsection (b), if, in a payment order received by the beneficiary's bank, the name, bank account number, or other identification of the beneficiary refers to a nonexistent or unidentifiable person or account, no person has rights as a beneficiary of the order and acceptance of the order cannot occur.

(b) If a payment order received by the beneficiary's bank identifies the beneficiary both by name and by an identifying or bank account number and the name and number identify different persons, the following rules apply:

(1) Except as otherwise provided in subsection (c), if the beneficiary's bank does not know that the name and number refer to different persons, it may rely on the number as the

proper identification of the beneficiary of the order. The beneficiary's bank need not determine whether the name and number refer to the same person.

(2) If the beneficiary's bank pays the person identified by name or knows that the name and number identify different persons, no person has rights as beneficiary except the person paid by the beneficiary's bank if that person was entitled to receive payment from the originator of the funds transfer. If no person has rights as beneficiary, acceptance of the order cannot occur.

(c) If (i) a payment order described in subsection (b) is accepted, (ii) the originator's payment order described the beneficiary inconsistently by name and number, and (iii) the beneficiary's bank pays the person identified by number as permitted by subsection (b)(1), the following rules apply:

(1) If the originator is a bank, the originator is obliged to pay its order.

(2) If the originator is not a bank and proves that the person identified by number was not entitled to receive payment from the originator, the originator is not obliged to pay its order unless the originator's bank proves that the originator, before acceptance of the originator's order, had notice that payment of a payment order issued by the originator might be made by the beneficiary's bank on the basis of an identifying or bank account number even if it identifies a person different from the named beneficiary. Proof of notice may be made by any admissible evidence. The originator's bank satisfies the burden of proof if it proves that the originator, before the payment order was accepted, signed a writing stating the information to which the notice relates.

(d) In a case governed by subsection (b)(1), if the beneficiary's bank rightfully pays the person identified by number and that person was not entitled to receive payment from the originator, the amount paid may be recovered from that person to the extent allowed by the law governing mistake and restitution as follows:

(1) If the originator is obliged to pay its payment order as stated in subsection (c), the originator has the right to recover.

(2) If the originator is not a bank and is not obliged to pay its payment order, the originator's bank has the right to recover. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) deals with the problem of payment orders issued to the beneficiary's bank for payment to nonexistent or unidentifiable persons or accounts. Since it is not possible in that case for the funds transfer to be completed, subsection (a) states that the order cannot be accepted. Under Section 4A-402(c), a sender of a payment order is not obliged to pay its order unless the beneficiary's bank accepts a payment order instructing payment to the beneficiary of that sender's order. Thus, if the beneficiary of a funds transfer is nonexistent or unidentifiable, each sender in the funds transfer that has paid its payment order is entitled to get its money back.

2. Subsection (b), which takes precedence over subsection (a), deals with the problem of payment orders in which the description of the beneficiary does not allow identification of the beneficiary because the beneficiary is described by

name and by an identifying number or an account number and the name and number refer to different persons. A very large percentage of payment orders issued to the beneficiary's bank by another bank are processed by automated means using machines capable of reading orders on standard formats that identify the beneficiary by an identifying number or the number of a bank account. The processing of the order by the beneficiary's bank and the crediting of the beneficiary's account are done by use of the identifying or bank account number without human reading of the payment order itself. The process is comparable to that used in automated payment of checks. The standard format, however, may also allow the inclusion of the name of the beneficiary and other information which can be useful to the beneficiary's bank and the beneficiary but which plays no part in the process of payment. If the beneficiary's bank has both the account number and name of the beneficiary supplied by the originator of the funds transfer, it is possible for the beneficiary's bank to determine whether the name and number refer to the same person, but if a duty to make that determination is imposed on the beneficiary's bank the benefits of automated payment are lost. Manual handling of payment orders is both expensive and subject to human error. If payment orders can be handled on an automated basis there are substantial economies of operation and the possibility of clerical error is reduced. Subsection (b) allows banks to utilize automated processing by allowing banks to act on the basis of the number without regard to the name if the bank does not know that the name and number refer to different persons. "Know" is defined in Section 1-201(25) to mean actual knowledge, and Section 1-201(27) states rules for determining when an organization has knowledge of information received by the organization. The time of payment is the pertinent time at which knowledge or lack of knowledge must be determined.

Although the clear trend is for beneficiary's banks to process payment orders by automated means, Section 4A-207 is not limited to cases in which processing is done by automated means. A bank that processes by semi-automated means or even manually may rely on number as stated in Section 4A-207.

In cases covered by subsection (b) the erroneous identification would in virtually all cases be the identifying or bank account number. In the typical case the error is made by the originator of the funds transfer. The originator should know the name of the person who is to receive payment and can further identify that person by an address that would normally be known to the originator. It is not unlikely, however, that the originator may not be sure whether the identifying or account number refers to the person the originator intends to pay. Subsection (b)(1) deals with the typical case in which the beneficiary's bank pays on the basis of the account number and is not aware at the time of payment that the named beneficiary is not the holder of the account which was paid. In some cases the false number will be the result of error by the originator. In other cases fraud is involved. For example, Doe is the holder of shares in Mutual Fund. Thief, impersonating Doe, requests redemption of the shares and directs Mutual Fund to wire the redemption proceeds to Doe's account #12345 in Beneficiary's Bank. Mutual Fund originates a funds transfer by issuing a payment order to Originator's Bank to make the payment to Doe's account #12345 in Beneficiary's Bank. Originator's Bank executes the order by issuing a conforming payment order to Beneficiary's Bank which makes payment to account #12345. That account is the account of Roe rather than Doe. Roe might be a person acting in concert with Thief or Roe might be an innocent third party. Assume that Roe is a gem merchant that agreed to sell gems to Thief who agreed to wire the purchase price to Roe's account in Beneficiary's Bank. Roe believed that the credit to Roe's account was a transfer of funds from Thief and released the gems to Thief in good faith in reliance on the payment. The case law is unclear on the responsibility of a beneficiary's bank in carrying out a payment order in which the identification of the beneficiary by name and number is conflicting. See Securities Fund Services, Inc. v. American National Bank, 542 F.Supp. 323 (N.D.Ill.1982) and Bradford Trust Co. v. Texas American Bank, 790 F.2d 407 (5thCir.1986). Section 4A-207 resolves the issue.

If Beneficiary's Bank did not know about the conflict between the name and number, subsection (b)(1) applies. Beneficiary's Bank has no duty to determine whether there is a conflict and it may rely on the number as the proper identification of the beneficiary of the order. When it accepts the order, it is entitled to payment from Originator's Bank. Section 4A-402(b). On the other hand, if Beneficiary's Bank knew about the conflict between the name and number and nevertheless paid Roe, subsection (b)(2) applies. Under that provision, acceptance of the payment order of Originator's Bank did not occur because there is no beneficiary of that order. Since acceptance did not occur Originator's Bank is not obliged to pay Beneficiary's Bank. Section 4A-402(b). Similarly, Mutual Fund is excused from its obligation to pay Originator's Bank. Section 4A-402(c). Thus, Beneficiary's Bank takes the loss. Its only cause of action is against Thief. Roe is not obliged to return the payment to the beneficiary's bank because Roe received the payment in good faith and for value. Article 4A makes irrelevant the issue of whether Mutual Fund was or was not negligent in issuing its payment order.

3. Normally, subsection (b)(1) will apply to the hypothetical case discussed in Comment 2. Beneficiary's Bank will pay on the basis of the number without knowledge of the conflict. In that case subsection (c) places the loss on either Mutual Fund or Originator's Bank. It is not unfair to assign the loss to Mutual Fund because it is the person who dealt with the impostor and it supplied the wrong account number. It could have avoided the loss if it had not used an account number that it was not sure was that of Doe. Mutual Fund, however, may not have been aware of the risk involved in giving both name and number. Subsection (c) is designed to protect the originator, Mutual Fund, in this case. Under that subsection, the originator is responsible for the inconsistent description of the beneficiary if it had notice that the order might be paid by the beneficiary's bank on the basis of the number. If the originator is a bank, the originator always has that responsibility. The rationale is that any bank should know how payment orders are processed and paid. If the originator is not a bank, the originator's bank must prove that its customer, the originator, had notice. Notice can be proved by any admissible evidence, but the bank can always prove notice by providing the customer with a written statement of the required information and obtaining the customer's signature to the statement. That statement will then apply to any payment order accepted by the bank thereafter. The information need not be supplied more than once.

In the hypothetical case if Originator's Bank made the disclosure stated in the last sentence of subsection (c)(2), Mutual Fund must pay Originator's Bank. Under subsection (d)(1), Mutual Fund has an action to recover from Roe if recovery from Roe is permitted by the law governing mistake and restitution. Under the assumed facts Roe should be entitled to keep the money as a person who took it in good faith and for value since it was taken as payment for the gems. In that case, Mutual Fund's only remedy is against Thief. If Roe was not acting in good faith, Roe has to return the money to Mutual Fund. If Originator's Bank does not prove that Mutual Fund had notice as stated in subsection (c)(2), Mutual Fund is not required to pay Originator's Bank. Thus, the risk of loss falls on Originator's Bank whose remedy is against Roe or Thief as stated above. Subsection (d)(2).

§ 25-4A-208. Misdescription of intermediary bank or beneficiary's bank.

(a) This subsection applies to a payment order identifying an intermediary bank or the beneficiary's bank only by an identifying number.

(1) The receiving bank may rely on the number as the proper identification of the intermediary or beneficiary's bank and need not determine whether the number identifies a bank.

(2) The sender is obliged to compensate the receiving bank for any loss and expenses incurred by the receiving bank as a result of its reliance on the number in executing or attempting to execute the order.

(b) This subsection applies to a payment order identifying an intermediary bank or the beneficiary's bank both by name and an identifying number if the name and number identify different persons.

(1) If the sender is a bank, the receiving bank may rely on the number as the proper identification of the intermediary or beneficiary's bank if the receiving bank, when it executes the sender's order, does not know that the name and number identify different persons. The receiving bank need not determine whether the name and number refer to the same person or whether the number refers to a bank. The sender is obliged to compensate the receiving bank for any loss and expenses incurred by the receiving bank as a result of its reliance on the number in executing or attempting to execute the order.

(2) If the sender is not a bank and the receiving bank proves that the sender, before the payment order was accepted, had notice that the receiving bank might rely on the number as the proper identification of the intermediary or beneficiary's bank even if it identifies a person different from the bank identified by name, the rights and obligations of the sender and the receiving bank are governed by subsection (b)(1), as though the sender were a bank. Proof of notice may be made by any admissible evidence. The receiving bank satisfies the burden of proof if it proves that the sender, before the payment order was accepted, signed a writing stating the information to which the notice relates.

(3) Regardless of whether the sender is a bank, the receiving bank may rely on the name as the proper identification of the intermediary or beneficiary's bank if the receiving bank, at the time it executes the sender's order, does not know that the name and number identify different persons. The receiving bank need not determine whether the name and number refer to the same person.

(4) If the receiving bank knows that the name and number identify different persons, reliance on either the name or the number in executing the sender's payment order is a breach of the obligation stated in G.S. 25-4A-302(a)(1). (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. This section addresses an issue similar to that addressed by Section 4A-207. Because of automation in the processing of payment orders, a payment order may identify the beneficiary's bank or an intermediary bank by an identifying number. The bank identified by number might or might not also be identified by name. The following two cases illustrate Section 4A-208(a) and (b):

Case #1. Originator's payment order to Originator's Bank identifies the beneficiary's bank as Bank A and instructs payment to Account #12345 in that bank. Originator's Bank executes Originator's order by issuing a payment order to Intermediary Bank. In the payment order of Originator's Bank the beneficiary's bank is identified as Bank A but is also identified by number, #67890. The identifying number refers to Bank B rather than Bank A. If processing by Intermediary Bank of the payment order of Originator's Bank is done by automated means, Intermediary Bank, in executing the order, will rely on the identifying number and will issue a payment order to Bank B rather than Bank A. If there is an Account #12345 in Bank

B, the payment order of Intermediary Bank would normally be accepted and payment would be made to a person not intended by Originator. In this case, Section 4A-208(b)(1) puts the risk of loss on Originator's Bank. Intermediary Bank may rely on the number #67890 as the proper identification of the beneficiary's bank. Intermediary Bank has properly executed the payment order of Originator's Bank. By using the wrong number to describe the beneficiary's bank, Originator's Bank has improperly executed Originator's payment order because the payment order of Originator's Bank provides for payment to the wrong beneficiary, the holder of Account #12345 in Bank B rather than the holder of Account #12345 in Bank A. Section 4A-302(a)(1) and Section 4A-303(c). Originator's Bank is not entitled to payment from Originator but is required to pay Intermediary Bank. Section 4A-303(c) and Section 4A-402(c). Intermediary Bank is also entitled to compensation for any loss and expenses resulting from the error by Originator's Bank.

If there is no Account #12345 in Bank B, the result is that there is no beneficiary of the payment order issued by Originator's Bank and the funds transfer will not be completed. Originator's Bank is not entitled to payment from Originator and Intermediary Bank is not entitled to payment from Originator's Bank. Section 4A-402(c). Since Originator's Bank improperly executed Originator's payment order it may be liable for damages under Section 4A-305. As stated above, Intermediary Bank is entitled to compensation for loss and expenses resulting from the error by Originator's Bank.

Case #2. Suppose the same payment order by Originator to Originator's Bank as in Case #1. In executing the payment order Originator's Bank issues a payment order to Intermediary Bank in which the beneficiary's bank is identified only by number, #67890. That number does not refer to Bank A. Rather, it identifies a person that is not a bank. If processing by Intermediary Bank of the payment order of Originator's Bank is done by automated means, Intermediary Bank will rely on the number #67890 to identify the beneficiary's bank. Intermediary Bank has no duty to determine whether the number identifies a bank. The funds transfer cannot be completed in this case because no bank is identified as the beneficiary's bank. Subsection (a) puts the risk of loss on Originator's Bank. Originator's Bank is not entitled to payment from Originator. Section 4A-402(c). Originator's Bank has improperly executed Originator's payment order and may be liable for damages under Section 4A-305. Originator's Bank is obliged to compensate Intermediary Bank for loss and expenses resulting from the error by Originator's Bank.

Subsection (a) also applies if #67890 identifies a bank, but the bank is not Bank A. Intermediary Bank may rely on the number as the proper identification of the beneficiary's bank. If the bank to which Intermediary Bank sends its payment order accepts the order, Intermediary Bank is entitled to payment from Originator's Bank, but Originator's Bank is not entitled to payment from Originator. The analysis is similar to that in Case #1.

2. Subsection (b)(2) of Section 4A-208 addresses cases in which an erroneous identification of a beneficiary's bank or intermediary bank by name and number is made in a payment order of a sender that is not a bank. Suppose Originator issues a payment order to Originator's Bank that instructs that bank to use an intermediary bank identified as Bank A and by an identifying number, #67890. The identifying number refers to Bank B. Originator intended to identify Bank A as intermediary bank. If Originator's Bank relied on the number and issued a payment order to Bank B the rights of Originator's Bank depend upon whether the proof of notice stated in subsection (b)(2) is made by Originator's Bank. If proof is made, Originator's Bank's rights are governed by subsection (b)(1) of Section 4A-208. Originator's Bank is not liable for breach of Section 4A-302(a)(1) and is entitled to compensation from Originator for any loss and expenses resulting from Originator's error. If notice is not proved, Originator's Bank may not rely on the number in executing Originator's payment order. Since Originator's Bank does not get the benefit of subsection (b)(1) in that case, Originator's Bank improperly executed Originator's payment order and is in breach of the obligation stated in Section 4A-302(a)(1). If notice is not given, Originator's Bank can rely on the name if it

is not aware of the conflict in name and number. Subsection (b)(3).

3. Although the principal purpose of Section 4A-208 is to accommodate automated processing of payment orders, Section 4A-208 applies regardless of whether processing is done by automation, semi-automated means or manually.

§ 25-4A-209. Acceptance of payment order.

(a) Subject to subsection (d), a receiving bank other than the beneficiary's bank accepts a payment order when it executes the order.

(b) Subject to subsections (c) and (d), a beneficiary's bank accepts a payment order at the earliest of the following times:

(1) When the bank (i) pays the beneficiary as stated in G.S. 25-4A-405(a) or G.S. 25-4A-405(b), or (ii) notifies the beneficiary of receipt of the order or that the account of the beneficiary has been credited with respect to the order unless the notice indicates that the bank is rejecting the order or that funds with respect to the order may not be withdrawn or used until receipt of payment from the sender of the order;

(2) When the bank receives payment of the entire amount of the sender's order pursuant to G.S. 25-4A-403(a)(1) or G.S. 25-4A-403(a)(2); or

(3) The opening of the next funds-transfer business day of the bank following the payment date of the order if, at that time, the amount of the sender's order is fully covered by a withdrawable credit balance in an authorized account of the sender or the bank has otherwise received full payment from the sender, unless the order was rejected before that time or is rejected within (i) one hour after that time, or (ii) one hour after the opening of the next business day of the sender following the payment date if that time is later. If notice of rejection is received by the sender after the payment date and the authorized account of the sender does not bear interest, the bank is obliged to pay interest to the sender on the amount of the order for the number of days elapsing after the payment date to the day the sender receives notice or learns that the order was not accepted, counting that day as an elapsed day. If the withdrawable credit balance during that period falls below the amount of the order, the amount of interest payable is reduced accordingly.

(c) Acceptance of a payment order cannot occur before the order is received by the receiving bank. Acceptance does not occur under subsection (b)(2) or (b)(3) if the beneficiary of the payment order does not have an account with the receiving bank, the account has been closed, or the receiving bank is not permitted by law to receive credits for the beneficiary's account.

(d) A payment order issued to the originator's bank cannot be accepted until the payment date if the bank is the beneficiary's bank, or the execution date if the bank is not the beneficiary's bank. If the originator's bank executes the originator's payment order before the execution date or pays the beneficiary of the originator's payment order before the payment date and the payment order is subsequently cancelled pursuant to G.S. 25-4A-211(b), the bank may recover from the beneficiary any payment received to the extent allowed by the law governing mistake and restitution. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. This section treats the sender's payment order as a request by the sender to the receiving bank to execute or pay the order and that request can be accepted or rejected by the receiving bank. Section 4A-209 defines when acceptance occurs. Section 4A-210 covers rejection. Acceptance of the payment order imposes an obligation on the receiving bank to the sender if the receiving bank is not the beneficiary's bank, or to the beneficiary if the receiving bank is the beneficiary's bank. These obligations are stated in Section 4A-302 and Section 4A-404.

2. Acceptance by a receiving bank other than the beneficiary's bank is defined in Section 4A-209(a). That subsection states the only way that a bank other than the beneficiary's bank can accept a payment order. A payment order to a bank other than the beneficiary's bank is, in effect, a request that the receiving bank execute the sender's order by issuing a payment order to the beneficiary's bank or to an intermediary bank. Normally, acceptance occurs at the time of execution, but there is an exception stated in subsection (d) and discussed in Comment 9. Execution occurs when the receiving bank "issues a payment order intended to carry out" the sender's order. Section 4A-301(a). In some cases the payment order issued by the receiving bank may not conform to the sender's order. For example, the receiving bank might make a mistake in the amount of its order, or the order might be issued to the wrong beneficiary's bank or for the benefit of the wrong beneficiary. In all of these cases there is acceptance of the sender's order by the bank when the receiving bank issues its order intended to carry out the sender's order, even though the bank's payment order does not in fact carry out the instruction of the sender. Improper execution of the sender's order may lead to liability to the sender for damages or it may mean that the sender is not obliged to pay its payment order. These matters are covered in Section 4A-303, Section 4A-305, and Section 4A-402.

3. A receiving bank has no duty to accept a payment order unless the bank makes an agreement, either before or after issuance of the payment order, to accept it, or acceptance is required by a funds transfer system rule. If the bank makes such an agreement it incurs a contractual obligation based on the agreement and may be held liable for breach of contract if a failure to execute violates the agreement. In many cases a bank will enter into an agreement with its customer to govern the rights and obligations of the parties with respect to payment orders issued to the bank by the customer or, in cases in which the sender is also a bank, there may be a funds transfer system rule that governs the obligations of a receiving bank with respect to payment orders transmitted over the system. Such agreements or rules can specify the circumstances under which a receiving bank is obliged to execute a payment order and can define the extent of liability of the receiving bank for breach of the agreement or rule. Section 4A-305(d) states the liability for breach of an agreement to execute a payment order.

4. In the case of a payment order issued to the beneficiary's bank, acceptance is defined in Section 4A-209(b). The function of a beneficiary's bank that receives a payment order is different from that of a receiving bank that receives a payment order for execution. In the typical case, the beneficiary's bank simply receives payment from the sender of the order, credits the account of the beneficiary and notifies the beneficiary of the credit. Acceptance by the beneficiary's bank does not create any obligation to the sender. Acceptance by the beneficiary's bank means that the bank is liable to the beneficiary for the amount of the order. Section 4A-404(a). There are three ways in which the beneficiary's bank can accept a payment order which are described in the following comments.

5. Under Section 4A-209(b)(1), the beneficiary's bank can accept a payment order by paying the beneficiary. In the normal case of crediting an account of the beneficiary, payment occurs when the beneficiary is given notice of the right to withdraw the credit, the credit

is applied to a debt of the beneficiary, or "funds with respect to the order" are otherwise made available to the beneficiary. Section 4A-405(a). The quoted phrase covers cases in which funds are made available to the beneficiary as a result of receipt of a payment order for the benefit of the beneficiary but the release of funds is not expressed as payment of the order. For example, the beneficiary's bank might express a release of funds equal to the amount of the order as a "loan" that will be automatically repaid when the beneficiary's bank receives payment by the sender of the order. If the release of funds is designated as a loan pursuant to a routine practice of the bank, the release is conditional payment of the order rather than a loan, particularly if normal incidents of a loan such as the signing of a loan agreement or note and the payment of interest are not present. Such a release of funds is payment to the beneficiary under Section 4A-405(a). Under Section 4A-405(c) the bank cannot recover the money from the beneficiary if the bank does not receive payment from the sender of the payment order that it accepted. Exceptions to this rule are stated in § 4A-405(d) and (e). The beneficiary's bank may also accept by notifying the beneficiary that the order has been received. "Notifies" is defined in Section 1-201(26). In some cases a beneficiary's bank will receive a payment order during the day but settlement of the sender's obligation to pay the order will not occur until the end of the day. If the beneficiary's bank wants to defer incurring liability to the beneficiary until the beneficiary's bank receives payment, it can do so. The beneficiary's bank incurs no liability to the beneficiary with respect to a payment order that it receives until it accepts the order. If the bank does not accept pursuant to subsection (b)(1), acceptance does not occur until the end of the day when the beneficiary's bank receives settlement. If the sender settles, the payment order will be accepted under subsection (b)(2) and the funds will be released to the beneficiary the next morning. If the sender doesn't settle, no acceptance occurs. In either case the beneficiary's bank suffers no loss.

6. In most cases the beneficiary's bank will receive a payment order from another bank. If the sender is a bank and the beneficiary's bank receives payment from the sender by final settlement through the Federal Reserve System or a funds transfer system (Section 4A-403(a)(1)) or, less commonly, through credit to an account of the beneficiary's bank with the sender or another bank (Section 4A-403(a)(2)), acceptance by the beneficiary's bank occurs at the time payment is made. Section 4A-209(b)(2). A minor exception to this rule is stated in Section 4A-209(c). Section 4A-209(b)(2) results in automatic acceptance of payment orders issued to a beneficiary's bank by means of Fedwire because the Federal Reserve account of the beneficiary's bank is credited and final payment is made to that bank when the payment order is received.

Subsection (b)(2) would also apply to cases in which the beneficiary's bank mistakenly pays a person who is not the beneficiary of the payment order issued to the beneficiary's bank. For example, suppose the payment order provides for immediate payment to Account #12345. The beneficiary's bank erroneously credits Account #12346 and notifies the holder of that account of the credit. No acceptance occurs in this case under subsection (b)(1) because the beneficiary of the order has not been paid or notified. The holder of Account #12345 is the beneficiary of the order issued to the beneficiary's bank. But acceptance will normally occur if the beneficiary's bank takes no other action, because the bank will normally receive settlement with respect to the payment order. At that time the bank has accepted because the sender paid its payment order. The bank is liable to pay the holder of Account #12345. The bank has paid the holder of Account #12346 by mistake, and has a right to recover the payment if the credit is withdrawn, to the extent provided in the law governing mistake and restitution.

7. Subsection (b)(3) covers cases of inaction by the beneficiary's bank. It applies whether or not the sender is a bank and covers a case in which the sender and the beneficiary both have accounts with the receiving bank and payment will be made by debiting the account of the sender and crediting the account of the beneficiary. Subsection (b)(3) is similar to subsection (b)(2) in that it bases acceptance by the beneficiary's bank on payment by the sender. Payment by the sender is effected by a debit to the sender's account if the account balance is sufficient to cover the amount of the order. On the payment date (Section

4A-401) of the order the beneficiary's bank will normally credit the beneficiary's account and notify the beneficiary of receipt of the order if it is satisfied that the sender's account balance covers the order or is willing to give credit to the sender. In some cases, however, the bank may not be willing to give credit to the sender and it may not be possible for the bank to determine until the end of the day on the payment date whether there are sufficient good funds in the sender's account. There may be various transactions during the day involving funds going into and out of the account. Some of these transactions may occur late in the day or after the close of the banking day. To accommodate this situation, subsection (b)(3) provides that the status of the account is determined at the opening of the next funds transfer business day of the beneficiary's bank after the payment date of the order. If the sender's account balance is sufficient to cover the order, the beneficiary's bank has a source of payment and the result in almost all cases is that the bank accepts the order at that time if it did not previously accept under subsection (b)(1). In rare cases, a bank may want to avoid acceptance under subsection (b)(3) by rejecting the order as discussed in Comment 8.

8. Section 4A-209 is based on a general principle that a receiving bank is not obliged to accept a payment order unless it has agreed or is bound by a funds transfer system rule to do so. Thus, provision is made to allow the receiving bank to prevent acceptance of the order. This principle is consistently followed if the receiving bank is not the beneficiary's bank. If the receiving bank is not the beneficiary's bank, acceptance is in the control of the receiving bank because it occurs only if the order is executed. But in the case of the beneficiary's bank acceptance can occur by passive receipt of payment under subsection (b)(2) or (3). In the case of a payment made by Fedwire acceptance cannot be prevented. In other cases the beneficiary's bank can prevent acceptance by giving notice of rejection to the sender before payment occurs under Section 4A-403(a)(1) or (2). A minor exception to the ability of the beneficiary's bank to reject is stated in Section 4A-502(c)(3).

Under subsection (b)(3) acceptance occurs at the opening of the next funds transfer business day of the beneficiary's bank following the payment date unless the bank rejected the order before that time or it rejects within one hour after that time. In some cases the sender and the beneficiary's bank may not be in the same time zone or the beginning of the business day of the sender and the funds transfer business day of the beneficiary's bank may not coincide. For example, the sender may be located in California and the beneficiary's bank in New York. Since in most cases notice of rejection would be communicated electronically or by telephone, it might not be feasible for the bank to give notice before one hour after the opening of the funds transfer business day in New York because at that hour, the sender's business day may not have started in California. For that reason, there are alternative deadlines stated in subsection (b)(3). In the case stated, the bank acts in time if it gives notice within one hour after the opening of the business day of the sender. But if the notice of rejection is received by the sender after the payment date, the bank is obliged to pay interest to the sender if the sender's account does not bear interest. In that case the bank had the use of funds of the sender that the sender could reasonably assume would be used to pay the beneficiary. The rate of interest is stated in Section 4A-506. If the sender receives notice on the day after the payment date the sender is entitled to one day's interest. If receipt of notice is delayed for more than one day, the sender is entitled to interest for each additional day of delay.

9. Subsection (d) applies only to a payment order by the originator of a funds transfer to the originator's bank and it refers to the following situation. On April 1, Originator instructs Bank A to make a payment on April 15 to the account of Beneficiary in Bank B. By mistake, on April 1, Bank A executes Originator's payment order by issuing a payment order to Bank B instructing immediate payment to Beneficiary. Bank B credited Beneficiary's account and immediately released the funds to Beneficiary. Under subsection (d) no acceptance by Bank A occurred on April 1 when Originator's payment order was executed because acceptance cannot occur before the execution date which in this case would be April 15 or shortly before that date. Section 4A-301(b). Under Section 4A-402(c), Originator is not obliged to pay Bank A until the order is

accepted and that can't occur until the execution date. But Bank A is required to pay Bank B when Bank B accepted Bank A's order on April 1. Unless Originator and Beneficiary are the same person, in almost all cases Originator is paying a debt owed to Beneficiary and early payment does not injure Originator because Originator does not have to pay Bank A until the execution date. Section 4A-402(c). Bank A takes the interest loss. But suppose that on April 3, Originator concludes that no debt was owed to Beneficiary or that the debt was less than the amount of the payment order. Under Section 4A-211(b) Originator can cancel its payment order if Bank A has not accepted. If early execution of Originator's payment order is acceptance, Originator can suffer a loss because cancellation after acceptance is not possible without the consent of Bank A and Bank B. Section 4A-211(c). If Originator has to pay Bank A, Originator would be required to seek recovery of the money from Beneficiary. Subsection (d) prevents this result and puts the risk of loss on Bank A by providing that the early execution does not result in acceptance until the execution date. Since on April 3 Originator's order was not yet accepted, Originator can cancel it under Section 4A-211(b). The result is that Bank A is not entitled to payment from Originator but is obliged to pay Bank B. Bank A has paid Beneficiary by mistake. If Originator's payment order is cancelled, Bank A becomes the originator of an erroneous funds transfer to Beneficiary. Bank A has the burden of recovering payment from Beneficiary on the basis of a payment by mistake. If Beneficiary received the money in good faith in payment of a debt owed to Beneficiary by Originator, the law of mistake and restitution may allow Beneficiary to keep all or part of the money received. If Originator owed money to Beneficiary, Bank A has paid Originator's debt and, under the law of restitution, which applies pursuant to Section 1-103, Bank A is subrogated to Beneficiary's rights against Originator on the debt.

If Bank A is the Beneficiary's bank and Bank A credited Beneficiary's account and released the funds to Beneficiary on April 1, the analysis is similar. If Originator's order is cancelled, Bank A has paid Beneficiary by mistake. The right of Bank A to recover the payment from Beneficiary is similar to Bank A's rights in the preceding paragraph.

§ 25-4A-210. Rejection of payment order.

(a) A payment order is rejected by the receiving bank by a notice of rejection transmitted to the sender orally, electronically, or in writing. A notice of rejection need not use any particular words and is sufficient if it indicates that the receiving bank is rejecting the order or will not execute or pay the order. Rejection is effective when the notice is given if transmission is by a means that is reasonable in the circumstances. If notice of rejection is given by a means that is not reasonable, rejection is effective when the notice is received. If an agreement of the sender and receiving bank establishes the means to be used to reject a payment order, (i) any means complying with the agreement is reasonable and (ii) any means not complying is not reasonable unless no significant delay in receipt of the notice resulted from the use of the noncomplying means.

(b) This subsection applies if a receiving bank other than the beneficiary's bank fails to execute a payment order despite the existence on the execution date of a withdrawable credit balance in an authorized account of the sender sufficient to cover the order. If the sender does not receive notice of rejection of the order on the execution date and the authorized account of the sender does not bear interest, the bank is obliged to pay interest to the sender on the amount of the order for the number of days elapsing after the execution date to the earlier of the day the order is cancelled pursuant to G.S. 25-4A-211(d) or the day the sender receives notice or learns that the order was not executed, counting the final day of the period as an elapsed day. If the withdrawable credit balance during that period falls below the amount of the order, the amount of interest is reduced accordingly.

(c) If a receiving bank suspends payments, all unaccepted payment orders issued to it are deemed rejected at the time the bank suspends payments.

(d) Acceptance of a payment order precludes a later rejection of the order. Rejection of a payment order precludes a later acceptance of the order. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. With respect to payment orders issued to a receiving bank other than the beneficiary's bank, notice of rejection is not necessary to prevent acceptance of the order. Acceptance can occur only if the receiving bank executes the order. Section 4A-209(a). But notice of rejection will routinely be given by such a bank in cases in which the bank cannot or is not willing to execute the order for some reason. There are many reasons why a bank doesn't execute an order. The payment order may not clearly instruct the receiving bank because of some ambiguity in the order or an internal inconsistency. In some cases, the receiving bank may not be able to carry out the instruction because of equipment failure, credit limitations on the receiving bank, or some other factor which makes proper execution of the order infeasible. In those cases notice of rejection is a means of informing the sender of the facts so that a corrected payment order can be transmitted or the sender can seek alternate means of completing the funds transfer. The other major reason for not executing an order is that the sender's account is insufficient to cover the order and the receiving bank is not willing to give credit to the sender. If the sender's account is sufficient to cover the order and the receiving bank chooses not to execute the order, notice of rejection is necessary to prevent liability to pay interest to the sender if the case falls within Section 4A-210(b) which is discussed in Comment 3.

2. A payment order to the beneficiary's bank can be accepted by inaction of the bank. Section 4A-209(b)(2) and (3). To prevent acceptance under those provisions it is necessary for the receiving bank to send notice of rejection before acceptance occurs. Subsection (a) of Section 4A-210 states the rule that rejection is accomplished by giving notice of rejection. This incorporates the definitions in Section 1-201(26). Rejection is effective when notice is given if it is given by a means that is reasonable in the circumstances. Otherwise it is effective when the notice is received. The question of when rejection is effective is important only in the relatively few cases under subsection (b)(2) and (3) in which a notice of rejection is necessary to prevent acceptance. The question of whether a particular means is reasonable depends on the facts in a particular case. In a very large percentage of cases the sender and the receiving bank will be in direct electronic contact with each other and in those cases a notice of rejection can be transmitted instantaneously. Since time is of the essence in a large proportion of funds transfers, some quick means of transmission would usually be required, but this is not always the case. The parties may specify by agreement the means by which communication between the parties is to be made.

3. Subsection (b) deals with cases in which a sender does not learn until after the execution date that the sender's order has not been executed. It applies only to cases in which the receiving bank was assured of payment because the sender's account was sufficient to cover the order. Normally, the receiving bank will accept the sender's order if it is assured of payment, but there may be some cases in which the bank chooses to reject. Unless the receiving bank had obligated itself by agreement to accept, the failure to accept is not wrongful. There is no duty of the receiving bank to accept the payment order unless it is obliged to accept by express agreement. Section 4A-212. But even if the bank has not acted wrongfully, the receiving bank had the use of the sender's money that the sender could reasonably assume was to be the source of payment of the funds transfer. Until the sender learns that the order was not accepted the sender is denied the use of that money. Subsection (b) obliges the receiving bank to pay interest to the sender as restitution unless

the sender receives notice of rejection on the execution date. The time of receipt of notice is determined pursuant to § 1-201(27). The rate of interest is stated in Section 4A-506. If the sender receives notice on the day after the execution date, the sender is entitled to one day's interest. If receipt of notice is delayed for more than one day, the sender is entitled to interest for each additional day of delay.

4. Subsection (d) treats acceptance and rejection as mutually exclusive. If a payment order has been accepted, rejection of that order becomes impossible. If a payment order has been rejected it cannot be accepted later by the receiving bank. Once notice of rejection has been given, the sender may have acted on the notice by making the payment through other channels. If the receiving bank wants to act on a payment order that it has rejected it has to obtain the consent of the sender. In that case the consent of the sender would amount to the giving of a second payment order that substitutes for the rejected first order. If the receiving bank suspends payments (Section 4-104(1)(k)), subsection (c) provides that unaccepted payment orders are deemed rejected at the time suspension of payments occurs. This prevents acceptance by passage of time under Section 4A-209(b)(3).

§ 25-4A-211. Cancellation and amendment of payment order.

(a) A communication of the sender of a payment order cancelling or amending the order may be transmitted to the receiving bank orally, electronically, or in writing. If a security procedure is in effect between the sender and the receiving bank, the communication is not effective to cancel or amend the order unless the communication is verified pursuant to the security procedure or the bank agrees to the cancellation or amendment.

(b) Subject to subsection (a), a communication by the sender cancelling or amending a payment order is effective to cancel or amend the order if notice of the communication is received at a time and in a manner affording the receiving bank a reasonable opportunity to act on the communication before the bank accepts the payment order.

(c) After a payment order has been accepted, cancellation or amendment of the order is not effective unless the receiving bank agrees or a funds-transfer system rule allows cancellation or amendment without agreement of the bank.

(1) With respect to a payment order accepted by a receiving bank other than the beneficiary's bank, cancellation or amendment is not effective unless a conforming cancellation or amendment of the payment order issued by the receiving bank is also made.

(2) With respect to a payment order accepted by the beneficiary's bank, cancellation or amendment is not effective unless the order was issued in execution of an unauthorized payment order, or because of a mistake by a sender in the funds transfer which resulted in the issuance of a payment order (i) that is a duplicate of a payment order previously issued by the sender, (ii) that orders payment to a beneficiary not entitled to receive payment from the originator, or (iii) that orders payment in an amount greater than the amount the beneficiary was entitled to receive from the originator. If the payment order is cancelled or amended, the beneficiary's bank is entitled to recover from the beneficiary any amount paid to the beneficiary to the

extent allowed by the law governing mistake and restitution.

(d) An unaccepted payment order is cancelled by operation of law at the close of the fifth funds-transfer business day of the receiving bank after the execution date or payment date of the order.

(e) A cancelled payment order cannot be accepted. If an accepted payment order is cancelled, the acceptance is nullified and no person has any right or obligation based on the acceptance. Amendment of a payment order is deemed to be cancellation of the original order at the time of amendment and issue of a new payment order in the amended form at the same time.

(f) Unless otherwise provided in an agreement of the parties or in a funds-transfer system rule, if the receiving bank, after accepting a payment order, agrees to cancellation or amendment of the order by the sender or is bound by a funds-transfer system rule allowing cancellation or amendment without the bank's agreement, the sender, whether or not cancellation or amendment is effective, is liable to the bank for any loss and expenses, including reasonable attorneys' fees, incurred by the bank as a result of the cancellation or amendment or attempted cancellation or amendment.

(g) A payment order is not revoked by the death or legal incapacity of the sender unless the receiving bank knows of the death or of an adjudication of incapacity by a court of competent jurisdiction and has reasonable opportunity to act before acceptance of the order.

(h) A funds-transfer system rule is not effective to the extent it conflicts with subsection (c)(2). (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. This section deals with cancellation and amendment of payment orders. It states the conditions under which cancellation or amendment is both effective and rightful. There is no concept of wrongful cancellation or amendment of a payment order. If the conditions stated in this section are not met the attempted cancellation or amendment is not effective. If the stated conditions are met the cancellation or amendment is effective and rightful. The sender of a payment order may want to withdraw or change the order because the sender has had a change of mind about the transaction or because the payment order was erroneously issued or for any other reason. One common situation is that of multiple transmission of the same order. The sender that mistakenly transmits the same order twice wants to correct the mistake by cancelling the duplicate order. Or, a sender may have intended to order a payment of $1,000,000 but mistakenly issued an order to pay $10,000,000. In this case the sender might try to correct the mistake by cancelling the order and issuing another order in the proper amount. Or, the mistake could be corrected by amending the order to change it to the proper amount. Whether the error is corrected by amendment or cancellation and reissue the net result is the same. This result is stated in the last sentence of subsection (e).

2. Subsection (a) allows a cancellation or amendment of a payment order to be communicated to the receiving bank "orally, electronically, or in writing." The quoted phrase is consistent with the language of Section 4A-103(a) applicable to payment orders. Cancellations and amendments are normally subject to verification pursuant to security procedures to the same extent as payment orders. Subsection (a) recognizes this fact by providing that in cases in which there is a security procedure in effect between the sender and the receiving bank the bank is not bound by a communication cancelling or amending an order unless verification has been made. This is necessary to protect the bank because under subsection (b) a cancellation or amendment can be effective by unilateral action of the sender. Without verification the bank cannot be sure whether the

communication was or was not effective to cancel or amend a previously verified payment order.

3. If the receiving bank has not yet accepted the order, there is no reason why the sender should not be able to cancel or amend the order unilaterally so long as the requirements of subsections (a) and (b) are met. If the receiving bank has accepted the order, it is possible to cancel or amend but only if the requirements of subsection (c) are met.

First consider the case of a receiving bank other than the beneficiary's bank. If the bank has not yet accepted the order, the sender can unilaterally cancel or amend. The communication amending or cancelling the payment order must be received in time to allow the bank to act on it before the bank issues its payment order in execution of the sender's order. The time that the sender's communication is received is governed by Section 4A-106. If a payment order does not specify a delayed payment date or execution date, the order will normally be executed shortly after receipt. Thus, as a practical matter, the sender will have very little time in which to instruct cancellation or amendment before acceptance. In addition, a receiving bank will normally have cut-off times for receipt of such communications, and the receiving bank is not obliged to act on communications received after the cut-off hour. Cancellation by the sender after execution of the order by the receiving bank requires the agreement of the bank unless a funds transfer rule otherwise provides. Subsection (c). Although execution of the sender's order by the receiving bank does not itself impose liability on the receiving bank (under Section 4A-402 no liability is incurred by the receiving bank to pay its order until it is accepted), it would commonly be the case that acceptance follows shortly after issuance. Thus, as a practical matter, a receiving bank that has executed a payment order will incur a liability to the next bank in the chain before it would be able to act on the cancellation request of its customer. It is unreasonable to impose on the receiving bank a risk of loss with respect to a cancellation request without the consent of the receiving bank.

The statute does not state how or when the agreement of the receiving bank must be obtained for cancellation after execution. The receiving bank's consent could be obtained at the time cancellation occurs or it could be based on a preexisting agreement. Or, a funds transfer system rule could provide that cancellation can be made unilaterally by the sender. By virtue of that rule any receiving bank covered by the rule is bound. Section 4A-501. If the receiving bank has already executed the sender's order, the bank would not consent to cancellation unless the bank to which the receiving bank has issued its payment order consents to cancellation of that order. It makes no sense to allow cancellation of a payment order unless all subsequent payment orders in the funds transfer that were issued because of the cancelled payment order are also cancelled. Under subsection (c)(1), if a receiving bank consents to cancellation of the payment order after it is executed, the cancellation is not effective unless the receiving bank also cancels the payment order issued by the bank.

4. With respect to a payment order issued to the beneficiary's bank, acceptance is particularly important because it creates liability to pay the beneficiary, it defines when the originator pays its obligation to the beneficiary, and it defines when any obligation for which the payment is made is discharged. Since acceptance affects the rights of the originator and the beneficiary it is not appropriate to allow the beneficiary's bank to agree to cancellation or amendment except in unusual cases. Except as provided in subsection (c)(2), cancellation or amendment after acceptance by the beneficiary's bank is not possible unless all parties affected by the order agree. Under subsection (c)(2), cancellation or amendment is possible only in the four cases stated. The following examples illustrate subsection (c)(2):

> *Case #1.* Originator's Bank executed a payment order issued in the name of its customer as sender. The order was not authorized by the customer and was fraudulently issued. Beneficiary's Bank accepted the payment order issued by Originator's Bank. Under subsection (c)(2) Originator's Bank can cancel the order if Beneficiary's Bank consents. It doesn't make any difference whether the payment order that Originator's Bank accepted was or was not enforceable against the customer under Section 4A-202(b). Verification under that provision is important in determining whether

Originator's Bank or the customer has the risk of loss, but it has no relevance under Section 4A-211(c)(2). Whether or not verified, the payment order was not authorized by the customer. Cancellation of the payment order to Beneficiary's Bank causes the acceptance of Beneficiary's Bank to be nullified. Subsection (e). Beneficiary's Bank is entitled to recover payment from the beneficiary to the extent allowed by the law of mistake and restitution. In this kind of case the beneficiary is usually a party to the fraud who has no right to receive or retain payment of the order.

Case #2. Originator owed Beneficiary $1,000,000 and ordered Bank A to pay that amount to the account of Beneficiary in Bank B. Bank A issued a complying order to Bank B, but by mistake issued a duplicate order as well. Bank B accepted both orders. Under subsection (c)(2)(i) cancellation of the duplicate order could be made by Bank A with the consent of Bank B. Beneficiary has no right to receive or retain payment of the duplicate payment order if only $1,000,000 was owed by Originator to Beneficiary. If Originator owed $2,000,000 to Beneficiary, the law of restitution might allow Beneficiary to retain the $1,000,000 paid by Bank B on the duplicate order. In that case Bank B is entitled to reimbursement from Bank A under subsection (f).

Case #3. Originator owed $1,000,000 to X. Intending to pay X, Originator ordered Bank A to pay $1,000,000 to Y's account in Bank B. Bank A issued a complying payment order to Bank B which Bank B accepted by releasing the $1,000,000 to Y. Under subsection (c)(2)(ii) Bank A can cancel its payment order to Bank B with the consent of Bank B if Y was not entitled to receive payment from Originator. Originator can also cancel its order to Bank A with Bank A's consent. Subsection (c)(1). Bank B may recover the $1,000,000 from Y unless the law of mistake and restitution allows Y to retain some or all of the amount paid. If no debt was owed to Y, Bank B should have a right of recovery.

Case #4. Originator owed Beneficiary $10,000. By mistake Originator ordered Bank A to pay $1,000,000 to the account of Beneficiary in Bank B. Bank A issued a complying order to Bank B which accepted by notifying Beneficiary of its right to withdraw $1,000,000. Cancellation is permitted in this case under subsection (c)(2)(iii). If Bank B paid Beneficiary it is entitled to recover the payment except to the extent the law of mistake and restitution allows Beneficiary to retain payment. In this case Beneficiary might be entitled to retain $10,000, the amount of the debt owed to Beneficiary. If Beneficiary may retain $10,000, Bank B would be entitled to $10,000 from Bank A pursuant to subsection (f). In this case Originator also cancelled its order. Thus Bank A would be entitled to $10,000 from Originator pursuant to subsection (f).

5. Unless constrained by a funds transfer system rule, a receiving bank may agree to cancellation or amendment of the payment order under subsection (c) but is not required to do so regardless of the circumstances. If the receiving bank has incurred liability as a result of its acceptance of the sender's order, there are substantial risks in agreeing to cancellation or amendment. This is particularly true for a beneficiary's bank. Cancellation or amendment after acceptance by the beneficiary's bank can be made only in the four cases stated and the beneficiary's bank may not have any way of knowing whether the requirements of subsection (c) have been met or whether it will be able to recover payment from the beneficiary that received payment. Even with indemnity the beneficiary's bank may be reluctant to alienate its customer, the beneficiary, by denying the customer the funds. Subsection (c) leaves the decision to the beneficiary's bank unless the consent of the beneficiary's bank is not required under a funds transfer system rule or other interbank agreement. If a receiving bank agrees to cancellation or amendment under subsection (c)(1) or (2), it is automatically entitled to indemnification from the sender under subsection (f). The indemnification provision recognizes that a sender has no right to cancel a payment order after it is accepted by the receiving bank. If the receiving bank agrees to cancellation, it is doing so as an accommodation to the sender and it

should not incur a risk of loss in doing so.

6. Acceptance by the receiving bank of a payment order issued by the sender is comparable to acceptance of an offer under the law of contracts. Under that law the death or legal incapacity of an offeror terminates the offer even though the offeree has no notice of the death or incapacity. Restatement Second, Contracts § 48. Comment a. to that section states that the "rule seems to be a relic of the obsolete view that a contract requires a 'meeting of minds,' and it is out of harmony with the modern doctrine that a manifestation of assent is effective without regard to actual mental assent." Subsection (g), which reverses the Restatement rule in the case of a payment order, is similar to Section 4-405(1) which applies to checks. Subsection (g) does not address the effect of the bankruptcy of the sender of a payment order before the order is accepted, but the principle of subsection (g) has been recognized in Bank of Marin v. England, 385 U.S. 99 (1966). Although Bankruptcy Code Section 542(c) may not have been drafted with wire transfers in mind, its language can be read to allow the receiving bank to charge the sender's account for the amount of the payment order if the receiving bank executed it in ignorance of the bankruptcy.

7. Subsection (d) deals with stale payment orders. Payment orders normally are executed on the execution date or the day after. An order issued to the beneficiary's bank is normally accepted on the payment date or the day after. If a payment order is not accepted on its execution or payment date or shortly thereafter, it is probable that there was some problem with the terms of the order or the sender did not have sufficient funds or credit to cover the amount of the order. Delayed acceptance of such an order is normally not contemplated, but the order may not have been cancelled by the sender. Subsection (d) provides for cancellation by operation of law to prevent an unexpected delayed acceptance.

8. A funds transfer system rule can govern rights and obligations between banks that are parties to payment orders transmitted over the system even if the rule conflicts with Article 4A. In some cases, however, a rule governing a transaction between two banks can affect a third party in an unacceptable way. Subsection (h) deals with such a case. A funds transfer system rule cannot allow cancellation of a payment order accepted by the beneficiary's bank if the rule conflicts with subsection (c)(2). Because rights of the beneficiary and the originator are directly affected by acceptance, subsection (c)(2) severely limits cancellation. These limitations cannot be altered by funds transfer system rule.

§ 25-4A-212. Liability and duty of receiving bank regarding unaccepted payment order.

If a receiving bank fails to accept a payment order that it is obliged by express agreement to accept, the bank is liable for breach of the agreement to the extent provided in the agreement or in this Article, but does not otherwise have any duty to accept a payment order or, before acceptance, to take any action, or refrain from taking action, with respect to the order except as provided in this Article or by express agreement. Liability based on acceptance arises only when acceptance occurs as stated in G.S. 25-4A-209, and liability is limited to that provided in this Article. A receiving bank is not the agent of the sender or beneficiary of the payment order it accepts, or of any other party to the funds transfer, and the bank owes no duty to any party to the funds transfer except as provided in this Article or by express agreement. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

With limited exceptions stated in this Article, the duties and obligations of receiving banks that carry out a funds transfer arise only as a result of acceptance of payment orders or of agreements made by receiving banks. Exceptions are stated in Section 4A-209(b)(3) and Section 4A-210(b). A receiving bank is not like a collecting bank under Article 4. No receiving bank, whether it be an originator's bank, an intermediary bank or a beneficiary's bank, is an agent for any other party in the funds transfer.

PART 3.

EXECUTION OF SENDER'S PAYMENT ORDER BY RECEIVING BANK.

§ 25-4A-301. Execution and execution date.

(a) A payment order is "executed" by the receiving bank when it issues a payment order intended to carry out the payment order received by the bank. A payment order received by the beneficiary's bank can be accepted but cannot be executed.

(b) "Execution date" of a payment order means the day on which the receiving bank may properly issue a payment order in execution of the sender's order. The execution date may be determined by instruction of the sender but cannot be earlier than the day the order is received and, unless otherwise determined, is the day the order is received. If the sender's instruction states a payment date, the execution date is the payment date or an earlier date on which execution is reasonably necessary to allow payment to the beneficiary on the payment date. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. The terms "executed," "execution" and "execution date" are used only with respect to a payment order to a receiving bank other than the beneficiary's bank. The beneficiary's bank can accept the payment order that it receives, but it does not execute the order. Execution refers to the act of the receiving bank in issuing a payment order "intended to carry out" the payment order that the bank received. A receiving bank has executed an order even if the order issued by the bank does not carry out the order received by the bank. For example, the bank may have erroneously issued an order to the wrong beneficiary, or in the wrong amount or to the wrong beneficiary's bank. In each of these cases execution has occurred but the execution is erroneous. Erroneous execution is covered in Section 4A-303.

2. "Execution date" refers to the time a payment order should be executed rather than the day it is actually executed. Normally the sender will not specify an execution date, but most payment orders are meant to be executed immediately. Thus, the execution date is normally the day the order is received by the receiving bank. It is common for the sender to specify a "payment date" which is defined in Section 4A-401 as "the day on which the amount of the order is payble to the beneficiary by the beneficiary's bank." Except for automated clearing house transfers, if a funds transfer is entirely within the United States and the payment is to be carried out electronically, the execution date is the payment date unless the order is received after the payment date. If the payment is to be carried out through an automated clearing house, execution may occur before the payment date. In an ACH transfer the beneficiary is usually paid one or two days after issue of the originator's payment order. The execution date is determined by the stated payment date and is a date before the payment date on which execution is reasonably necessary to allow payment on the payment date. A funds transfer system rule could also determine the execution date of orders received by the re-

ceiving bank if both the sender and the receiving bank are participants in the funds transfer system. The execution date can be determined by the payment order itself or by separate instructions of the sender or an agreement of the sender and the receiving bank. The second sentence of subsection (b) must be read in the light of Section 4A-106 which states that if a payment order is received after the cut-off time of the receiving bank it may be treated by the bank as received at the opening of the next funds transfer business day.

3. Execution on the execution date is timely, but the order can be executed before or after the execution date. Section 4A-209(d) and Section 4A-402(c) state the consequences of early execution and Section 4A-305(a) states the consequences of late execution.

§ 25-4A-302. Obligations of receiving bank in execution of payment order.

(a) Except as provided in subsections (b) through (d), if the receiving bank accepts a payment order pursuant to G.S. 25-4A-209 (a), the bank has the following obligations in executing the order:

(1) The receiving bank is obliged to issue, on the execution date, a payment order complying with the sender's order and to follow the sender's instructions concerning (i) any intermediary bank or funds-transfer system to be used in carrying out the funds transfer, or (ii) the means by which payment orders are to be transmitted in the funds transfer. If the originator's bank issues a payment order to an intermediary bank, the originator's bank is obliged to instruct the intermediary bank according to the instruction of the originator. An intermediary bank in the funds transfer is similarly bound by an instruction given to it by the sender of the payment order it accepts.

(2) If the sender's instruction states that the funds transfer is to be carried out telephonically or by wire transfer or otherwise indicates that the funds transfer is to be carried out by the most expeditious means, the receiving bank is obliged to transmit its payment order by the most expeditious available means, and to instruct any intermediary bank accordingly. If a sender's instruction states a payment date, the receiving bank is obliged to transmit its payment order at a time and by means reasonably necessary to allow payment to the beneficiary on the payment date or as soon thereafter as is feasible.

(b) Unless otherwise instructed, a receiving bank executing a payment order may (i) use any funds-transfer system if use of that system is reasonable in the circumstances, and (ii) issue a payment order to the beneficiary's bank or to an intermediary bank through which a payment order conforming to the sender's order can expeditiously be issued to the beneficiary's bank if the receiving bank exercises ordinary care in the selection of the intermediary bank. A receiving bank is not required to follow an instruction of the sender designating a funds-transfer system to be used in carrying out the funds transfer if the receiving bank, in good faith, determines that it is not feasible to follow the instruction or that following the instruction would unduly delay completion of the funds transfer.

(c) Unless subsection (a)(2) applies or the receiving bank is otherwise instructed, the bank may execute a payment order by transmitting its payment order by first class mail or by any means reasonable in the circumstances. If the receiving bank is instructed to execute the sender's order by transmitting its payment order by a particular means, the receiving bank may issue its payment order by the means stated or by any means as expeditious as the means stated.

(d) Unless instructed by the sender, (i) the receiving bank may not obtain payment of its charges for services and expenses in connection with the execution of the sender's order by issuing a payment order in an amount equal to the amount of the sender's order less the amount of the charges, and (ii) may not instruct a subsequent receiving bank to obtain payment of its charges in the same manner. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. In the absence of agreement, the receiving bank is not obliged to execute an order of the sender. Section 4A-212. Section 4A-302 states the manner in which the receiving bank may execute the sender's order if execution occurs. Subsection (a)(1) states the residual rule. The payment order issued by the receiving bank must comply with the sender's order and, unless some other rule is stated in the section, the receiving bank is obliged to follow any instruction of the sender concerning which funds transfer system is to be used, which intermediary banks are to be used, and what means of transmission is to be used. The instruction of the sender may be incorporated in the payment order itself or may be given separately. For example, there may be a master agreement between the sender and receiving bank containing instructions governing payment orders to be issued from time to time by the sender to the receiving bank. In most funds transfers, speed is a paramount consideration. A sender that wants assurance that the funds transfer will be expeditiously completed can specify the means to be used. The receiving bank can follow the instructions literally or it can use an equivalent means. For example, if the sender instructs the receiving bank to transmit by telex, the receiving bank could use telephone instead. Subsection (c). In most cases the sender will not specify a particular means but will use a general term such as "by wire" or "wire transfer" or "as soon as possible." These words signify that the sender wants a same-day transfer. In these cases the receiving bank is required to use a telephonic or electronic communication to transmit its order and is also required to instruct any intermediary bank to which it issues its order to transmit by similar means. Subsection (a)(2). In other cases, such as an automated clearing house transfer, a same-day transfer is not contemplated. Normally the sender's instruction or the context in which the payment order is received makes clear the type of funds transfer that is appropriate. If the sender states a payment date with respect to the payment order, the receiving bank is obliged to execute the order at a time and in a manner to meet the payment date if that is feasible. Subsection (a)(2). This provision would apply to many ACH transfers made to pay recurring debts of the sender. In other cases, involving relatively small amounts, time may not be an important factor and cost may be a more important element. Fast means, such as telephone or electronic transmission, are more expensive than slow means such as mailing. Subsection (c) states that in the absence of instructions the receiving bank is given discretion to decide. It may issue its payment order by first class mail or by any means reasonable in the circumstances. Section 4A-305 states the liability of a receiving bank for breach of the obligations stated in Section 4A-302.

2. Subsection (b) concerns the choice of intermediary banks to be used in completing the funds transfer, and the funds transfer system to be used. If the receiving bank is not instructed about the matter, it can issue an order directly to the beneficiary's bank or can issue an order to an intermediary bank. The receiving bank also has discretion concerning use of a funds transfer system. In some cases it may be reasonable to use either an automated clearing house system or a wire transfer system such as Fedwire or CHIPS. Normally, the receiving bank will follow the instruction of the sender in these matters, but in some cases it may be prudent for the bank not to follow instructions. The sender may have designated a funds

transfer system to be used in carrying out the funds transfer, but it may not be feasible to use the designated system because of some impediment such as a computer breakdown which prevents prompt execution of the order. The receiving bank is permitted to use an alternate means of transmittal in a good faith effort to execute the order expeditiously. The same leeway is not given to the receiving bank if the sender designates an intermediary bank through which the funds transfer is to be routed. The sender's designation of that intermediary bank may mean that the beneficiary's bank is expecting to obtain a credit from that intermediary bank and may have relied on that anticipated credit. If the receiving bank uses another intermediary bank the expectations of the beneficiary's bank may not be realized. The receiving bank could choose to route the transfer to another intermediary bank and then to the designated intermediary bank if there was some reason such as a lack of a correspondent-bank relationship or a bilateral credit limitation, but the designated intermediary bank cannot be circumvented. To do so violates the sender's instructions.

3. The normal rule, under subsection (a)(1), is that the receiving bank, in executing a payment order, is required to issue a payment order that complies as to amount with that of the sender's order. In most cases the receiving bank issues an order equal to the amount of the sender's order and makes a separate charge for services and expenses in executing the sender's order. In some cases, particularly if it is an intermediary bank that is executing an order, charges are collected by deducting them from the amount of the payment order issued by the executing bank. If that is done, the amount of the payment order accepted by the beneficiary's bank will be slightly less than the amount of the originator's payment order. For example, Originator, in order to pay an obligation of $1,000,000 owed to Beneficiary, issues a payment order to Originator's Bank to pay $1,000,000 to the account of Beneficiary in Beneficiary's Bank. Originator's Bank issues a payment order to Intermediary Bank for $1,000,000 and debits Originator's account for $1,000,010. The extra $10 is the fee of Originator's Bank. Intermediary Bank executes the payment order of Originator's Bank by issuing a payment order to Beneficiary's Bank for $999,990, but under § 4A-402(c) is entitled to receive $1,000,000 from Originator's bank. The $10 difference is the fee of Intermediary Bank. Beneficiary's Bank credits Beneficiary's account for $999,990. When Beneficiary's Bank accepts the payment order of Intermediary Bank the result is a payment of $999,990 from Originator to Beneficiary. Section 4A-406(a). If that payment discharges the $1,000,000 debt, the effect is that Beneficiary has paid the charges of Intermediary Bank and Originator has paid charges of Originator's Bank. Subsection (d) of Section 4A-302 allows Intermediary Bank to collect its charges by deducting them from the amount of the payment order, but only if instructed to do so by Originator's Bank. Originator's Bank is not authorized to give that instruction to Intermediary Bank unless Originator authorized the instruction. Thus, Originator can control how the charges of Originator's Bank and Intermediary Bank are to be paid. Subsection (d) does not apply to charges of Beneficiary's Bank to Beneficiary.

In the case discussed in the preceding paragraph the $10 charge is trivial in relation to the amount of the payment and it may not be important to Beneficiary how the charge is paid. But it may be very important if the $1,000,000 obligation represented the price of exercising a right such as an option favorable to Originator and unfavorable to Beneficiary. Beneficiary might well argue that it was entitled to receive $1,000,000. If the option was exercised shortly before its expiration date, the result could be loss of the option benefit because the required payment of $1,000,000 was not made before the option expired. Section 4A-406(c) allows Originator to preserve the option benefit. The amount received by Beneficiary is deemed to be $1,000,000 unless Beneficiary demands the $10 and Originator does not pay it.

§ 25-4A-303. Erroneous execution of payment order.

(a) A receiving bank that (i) executes the payment order of the sender by issuing a payment order in an amount greater than the amount of the sender's order, or (ii) issues a payment order in execution of the sender's order and then issues a duplicate order, is entitled to payment of the amount of the sender's order under G.S. 25-4A-402(c) if that subsection is otherwise satisfied. The bank is entitled to recover from the beneficiary of the erroneous order the excess payment received to the extent allowed by the law governing mistake and restitution.

(b) A receiving bank that executes the payment order of the sender by issuing a payment order in an amount less than the amount of the sender's order is entitled to payment of the amount of the sender's order under G.S. 25-4A-402(c) if (i) that subsection is otherwise satisfied and (ii) the bank corrects its mistake by issuing an additional payment order for the benefit of the beneficiary of the sender's order. If the error is not corrected, the issuer of the erroneous order is entitled to receive or retain payment from the sender of the order it accepted only to the extent of the amount of the erroneous order. This subsection does not apply if the receiving bank executes the sender's payment order by issuing a payment order in an amount less than the amount of the sender's order for the purpose of obtaining payment of its charges for services and expenses pursuant to instruction of the sender.

(c) If a receiving bank executes the payment order of the sender by issuing a payment order to a beneficiary different from the beneficiary of the sender's order and the funds transfer is completed on the basis of that error, the sender of the payment order that was erroneously executed and all previous senders in the funds transfer are not obliged to pay the payment orders they issued. The issuer of the erroneous order is entitled to recover from the beneficiary of the order the payment received to the extent allowed by the law governing mistake and restitution. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. Section 4A-303 states the effect of erroneous execution of a payment order by the receiving bank. Under Section 4A-402(c) the sender of a payment order is obliged to pay the amount of the order to the receiving bank if the bank executes the order, but the obligation to pay is excused if the beneficiary's bank does not accept a payment order instructing payment to the beneficiary of the sender's order. If erroneous execution of the sender's order causes the wrong beneficiary to be paid, the sender is not required to pay. If erroneous execution causes the wrong amount to be paid the sender is not obliged to pay the receiving bank an amount in excess of the amount of the sender's order. Section 4A-303 takes precedence over Section 4A-402(c) and states the liability of the sender and the rights of the receiving bank in various cases of erroneous execution.

2. Subsections (a) and (b) deal with cases in which the receiving bank executes by issuing a payment order in the wrong amount. If Originator ordered Originator's Bank to pay $1,000,000 to the account of Beneficiary in Beneficiary's Bank, but Originator's Bank erroneously instructed Beneficiary's Bank to pay $2,000,000 to Beneficiary's account, subsection (a) applies. If Beneficiary's Bank accepts the order of Originator's Bank, Beneficiary's Bank is entitled to receive $2,000,000 from Originator's Bank, but Originator's Bank is entitled to receive only $1,000,000 from Originator. Originator's Bank is entitled

to recover the overpayment from Beneficiary to the extent allowed by the law governing mistake and restitution. Originator's Bank would normally have a right to recover the overpayment from Beneficiary, but in unusual cases the law of restitution might allow Beneficiary to keep all or part of the overpayment. For example, if Originator owed $2,000,000 to Beneficiary and Beneficiary received the extra $1,000,000 in good faith in discharge of the debt, Beneficiary may be allowed to keep it. In this case Originator's Bank has paid an obligation of Originator and under the law of restitution, which applies through Section 1-103, Originator's Bank would be subrogated to Beneficiary's rights against Originator on the obligation paid by Originator's Bank.

If Originator's Bank erroneously executed Originator's order by instructing Beneficiary's Bank to pay less than $1,000,000, subsection (b) applies. If Originator's Bank corrects its error by issuing another payment order to Beneficiary's Bank that results in payment of $1,000,000 to Beneficiary, Originator's Bank is entitled to payment of $1,000,000 from Originator. If the mistake is not corrected, Originator's Bank is entitled to payment from Originator only in the amount of the order issued by Originator's Bank.

3. Subsection (a) also applies to duplicate payment orders. Assume Originator's Bank properly executes Originator's $1,000,000 payment order and then by mistake issues a second $1,000,000 payment order in execution of Originator's order. If Beneficiary's Bank accepts both orders issued by Originator's Bank, Beneficiary's Bank is entitled to receive $2,000,000 from Originator's Bank but Originator's Bank is entitled to receive only $1,000,000 from Originator. The remedy of Originator's Bank is the same as that of a receiving bank that executes by issuing an order in an amount greater than the sender's order. It may recover the overpayment from Beneficiary to the extent allowed by the law governing mistake and restitution and in a proper case as stated in Comment 2 may have subrogation rights if it is not entitled to recover from Beneficiary.

4. Suppose Originator instructs Originator's Bank to pay $1,000,000 to Account #12345 in Beneficiary's Bank. Originator's Bank erroneously instructs Beneficiary's Bank to pay $1,000,000 to Account #12346 and Beneficiary's Bank accepted. Subsection (c) covers this case. Originator is not obliged to pay its payment order, but Originator's Bank is required to pay $1,000,000 to Beneficiary's Bank. The remedy of Originator's Bank is to recover $1,000,000 from the holder of Account #12346 that received payment by mistake. Recovery based on the law of mistake and restitution is described in Comment 2.

§ 25-4A-304. Duty of sender to report erroneously executed payment order.

If the sender of a payment order that is erroneously executed as stated in G.S. 25-4A-303 receives notification from the receiving bank that the order was executed or that the sender's account was debited with respect to the order, the sender has a duty to exercise ordinary care to determine, on the basis of information available to the sender, that the order was erroneously executed and to notify the bank of the relevant facts within a reasonable time not exceeding 90 days after the notification from the bank was received by the sender. If the sender fails to perform that duty, the bank is not obliged to pay interest on any amount refundable to the sender under G.S. 25-4A-402(d) for the period before the bank learns of the execution error. The bank is not entitled to any recovery from the sender on account of a failure by the sender to perform the duty stated in this section. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

This section is identical in effect to Section 4A-204 which applies to unauthorized orders issued in the name of a customer of the receiving bank. The rationale is stated in Comment 2 to Section 4A-204.

§ 25-4A-305. Liability for late or improper execution or failure to execute payment order.

(a) If a funds transfer is completed but execution of a payment order by the receiving bank in breach of G.S. 25-4A-302 results in delay in payment to the beneficiary, the bank is obliged to pay interest to either the originator or the beneficiary of the funds transfer for the period of delay caused by the improper execution. Except as provided in subsection (c), additional damages are not recoverable.

(b) If execution of a payment order by a receiving bank in breach of G.S. 25-4A-302 results in (i) noncompletion of the funds transfer, (ii) failure to use an intermediary bank designated by the originator, or (iii) issuance of a payment order that does not comply with the terms of the payment order of the originator, the bank is liable to the originator for its expenses in the funds transfer and for incidental expenses and interest losses, to the extent not covered by subsection (a), resulting from the improper execution. Except as provided in subsection (c), additional damages are not recoverable.

(c) In addition to the amounts payable under subsections (a) and (b), damages, including consequential damages, are recoverable to the extent provided in an express written agreement of the receiving bank.

(d) If a receiving bank fails to execute a payment order it was obliged by express agreement to execute, the receiving bank is liable to the sender for its expenses in the transaction and for incidental expenses and interest losses resulting from the failure to execute. Additional damages, including consequential damages, are recoverable to the extent provided in an express written agreement of the receiving bank, but are not otherwise recoverable.

(e) Reasonable attorneys' fees are recoverable if demand for compensation under subsection (a) or (b) is made and refused before an action is brought on the claim. If a claim is made for breach of an agreement under subsection (d) and the agreement does not provide for damages, reasonable attorneys' fees are recoverable if demand for compensation under subsection (d) is made and refused before an action is brought on the claim.

(f) Except as stated in this section, the liability of a receiving bank under subsections (a) and (b) may not be varied by agreement. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) covers cases of delay in completion of a funds transfer resulting from an execution by a receiving bank in breach of Section 4A-302(a). The receiving bank is obliged to pay interest on the amount of the order for the period of the delay. The rate of interest is stated in Section 4A-506. With respect to wire transfers (other than ACH transactions) within the United States, the expectation is that the funds transfer will be completed the same day. In those

cases, the originator can reasonably expect that the originator's account will be debited on the same day as the beneficiary's account is credited. If the funds transfer is delayed, compensation can be paid either to the originator or to the beneficiary. The normal practice is to compensate the beneficiary's bank to allow that bank to compensate the beneficiary by back-valuing the payment by the number of days of delay. Thus, the beneficiary is in the same position that it would have been in if the funds transfer had been completed on the same day. Assume on Day 1, Originator's Bank issues its payment order to Intermediary Bank which is received on that day. Intermediary Bank does not execute that order until Day 2 when it issues an order to Beneficiary's Bank which is accepted on that day. Intermediary Bank complies with subsection (a) by paying one day's interest to Beneficiary's Bank for the account of Beneficiary.

2. Subsection (b) applies to cases of breach of Section 4A-302 involving more than mere delay. In those cases the bank is liable for damages for improper execution but they are limited to compensation for interest losses and incidental expenses of the sender resulting from the breach, the expenses of the sender in the funds transfer and attorney's fees. This subsection reflects the judgement that imposition of consequential damages on a bank for commission of an error is not justified.

The leading common law case on the subject of consequential damages is Evra Corp. v. Swiss Bank Corp., 673 F.2d 951 (7th Cir. 1982), in which Swiss Bank, an intermediary bank, failed to execute a payment order. Because the beneficiary did not receive timely payment the originator lost a valuable ship charter. The lower court awarded the originator $2.1 million for lost profits even though the amount of the payment order was only $27,000. The Seventh Circuit reversed, in part on the basis of the common law rule of Hadley v. Baxendale that consequential damages may not be awarded unless the defendant is put on notice of the special circumstances giving rise to them. Swiss Bank may have known that the originator was paying the shipowner for the hire of a vessel but did not know that a favorable charter would be lost if the payment was delayed. "Electronic payments are not so unusual as to automatically place a bank on notice of extraordinary consequences if such a transfer goes awry. Swiss Bank did not have enough information to infer that if it lost a $27,000 payment order it would face liability in excess of $2 million." 673 F.2d at 956.

If Evra means that consequential damages can be imposed if the culpable bank has notice of particular circumstances giving rise to the damages, it does not provide an acceptable solution to the problem of bank liability for consequential damages. In the typical case transmission of the payment order is made electronically. Personnel of the receiving bank that process payment orders are not the appropriate people to evaluate the risk of liability for consequential damages in relation to the price charged for the wire transfer service. Even if notice is received by higher level management personnel who could make an appropriate decision whether the risk is justified by the price, liability based on notice would require evaluation of payment orders on an individual basis. This kind of evaluation is inconsistent with the high-speed, low-price, mechanical nature of the processing system that characterizes wire transfers. Moreover, in Evra the culpable bank was an intermediary bank with which the originator did not deal. Notice to the originator's bank would not bind the intermediary bank, and it seems impractical for the originator's bank to convey notice of this kind to intermediary banks in the funds transfer. The success of the wholesale wire transfer industry has largely been based on its ability to effect payment at low cost and great speed. Both of these essential aspects of the modern wire transfer system would be adversely affected by a rule that imposed on banks liability for consequential damages. A banking industry amicus brief in Evra stated: "Whether banks can continue to make EFT services available on a widespread basis, by charging reasonable rates, depends on whether they can do so without incurring unlimited consequential risks. Certainly, no bank would handle for $3.25 a transaction entailing potential liability in the millions of dollars."

As the court in Evra also noted, the originator of the funds transfer is in the best position to evaluate the risk that a funds transfer will not be made on time and to manage that risk by issuing a payment order in time to allow monitoring of the transaction. The originator, by asking the beneficiary, can quickly determine if the funds transfer has been completed. If the originator has sent the payment order at a time that allows a reasonable margin for correcting error, no loss is likely to result if the transaction is monitored. The other published cases on this issue reach the Evra result. Central Coordinates, Inc. v. Morgan Guaranty Trust Co., 40 U.C.C. Rep. Serv. 1340 (N.Y.Sup.Ct.1985), and Gatoil (U.S.A.), Inc. v. Forest Hill State Bank, 1 U.C.C. Rep.Serv.2d 171 (D.Md.1986).

Subsection (c) allows the measure of damages in subsection (b) to be increased by an express written agreement of the receiving bank. An originator's bank might be willing to assume additional responsibilities and incur additional liability in exchange for a higher fee.

3. Subsection (d) governs cases in which a receiving bank has obligated itself by express agreement to accept payment orders of a sender. In the absence of such an agreement there is no obligation by a receiving bank to accept a payment order. Section 4A-212. The measure of damages for breach of an agreement to accept a payment order is the same as that stated in subsection (b). As in the case of subsection (b), additional damages, including consequential damages, may be recovered to the extent stated in an express written agreement of the receiving bank.

4. Reasonable attorney's fees are recoverable only in cases in which damages are limited to statutory damages stated in subsection (a), (b) and (d). If additional damages are recoverable because provided for by an express written agreement, attorney's fees are not recoverable. The rationale is that there is no need for statutory attorney's fees in the latter case, because the parties have agreed to a measure of damages which may or may not provide for attorney's fees.

5. The effect of subsection (f) is to prevent reduction of a receiving bank's liability under Section 4A-305.

PART 4.

PAYMENT.

§ 25-4A-401. Payment date.

"Payment date" of a payment order means the day on which the amount of the order is payable to the beneficiary by the beneficiary's bank. The payment date may be determined by instruction of the sender but cannot be earlier than the day the order is received by the beneficiary's bank and, unless otherwise determined, is the day the order is received by the beneficiary's bank. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

"Payment date" refers to the day the beneficiary's bank is to pay the beneficiary. The payment date may be expressed in various ways so long as it indicates the day the beneficiary is to receive payment. For example, in ACH transfers the payment date is the equivalent of "settlement date" or "effective date." Payment date applies to the payment order issued to the beneficiary's bank, but a payment order issued to a receiving bank other than the beneficiary's bank may also state a date for payment to the beneficiary. In the latter case, the statement of a payment date is to instruct the receiving bank concerning time of execution of the sender's order. Section 4A-301(b).

§ 25-4A-402. Obligation of sender to pay receiving bank.

(a) This section is subject to G.S. 25-4A-205 and G.S. 25-4A-207.

(b) With respect to a payment order issued to the beneficiary's bank, acceptance of the order by the bank obliges the sender to pay the bank the amount of the order, but payment is not due until the payment date of the order.

(c) This subsection is subject to subsection (e) and to G.S. 25-4A-303. With respect to a payment order issued to a receiving bank other than the beneficiary's bank, acceptance of the order by the receiving bank obliges the sender to pay the bank the amount of the sender's order. Payment by the sender is not due until the execution date of the sender's order. The obligation of that sender to pay its payment order is excused if the funds transfer is not completed by acceptance by the beneficiary's bank of a payment order instructing payment to the beneficiary of that sender's payment order.

(d) If the sender of a payment order pays the order and was not obliged to pay all or part of the amount paid, the bank receiving payment is obliged to refund payment to the extent the sender was not obliged to pay. Except as provided in G.S. 25-4A-204 and G.S. 25-4A-304, interest is payable on the refundable amount from the date of payment.

(e) If a funds transfer is not completed as stated in subsection (c) and an intermediary bank is obliged to refund payment as stated in subsection (d) but is unable to do so because not permitted by applicable law or because the bank suspends payments, a sender in the funds transfer that executed a payment order in compliance with an instruction, as stated in G.S. 25-4A-302(a)(1), to route the funds transfer through that intermediary bank is entitled to receive or retain payment from the sender of the payment order that it accepted. The first sender in the funds transfer that issued an instruction requiring routing through that intermediary bank is subrogated to the right of the bank that paid the intermediary bank to refund as stated in subsection (d).

(f) The right of the sender of a payment order to be excused from the obligation to pay the order as stated in subsection (c) or to receive refund under subsection (d) may not be varied by agreement. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. Subsection (b) states that the sender of a payment order to the beneficiary's bank must pay the order when the beneficiary's bank accepts the order. At that point the beneficiary's bank is obliged to pay the beneficiary. Section 4A-404(a). The last clause of subsection (b) covers a case of premature acceptance by the beneficiary's bank. In some funds transfers, notably automated clearing house transfers, a beneficiary's bank may receive a payment order with a payment date after the day the order is received. The beneficiary's bank might accept the order before the payment date by notifying the beneficiary of receipt of the order. Although the acceptance obliges the beneficiary's bank to pay the beneficiary, payment is not due until the payment date. The last clause of subsection (b) is consistent with that result. The beneficiary's bank is also not entitled to payment from the sender until the payment date.

2. Assume that Originator instructs Bank A to order immediate payment to the account of Beneficiary in Bank B. Execution of Originator's payment order

by Bank A is acceptance under Section 4A-209(a). Under the second sentence of Section 4A-402(c) the acceptance creates an obligation of Originator to pay Bank A the amount of the order. The last clause of that sentence deals with attempted funds transfers that are not completed. In that event the obligation of the sender to pay its payment order is excused. Originator makes payment to Beneficiary when Bank B, the beneficiary's bank, accepts a payment order for the benefit of Beneficiary. Section 4A-406(a). If that acceptance by Bank B does not occur, the funds transfer has miscarried because Originator has not paid Beneficiary. Originator doesn't have to pay its payment order, and if it has already paid it is entitled to refund of the payment with interest. The rate of interest is stated in Section 4A-506. This "money-back guarantee" is an important protection of Originator. Originator is assured that it will not lose its money if something goes wrong in the transfer. For example, risk of loss resulting from payment to the wrong beneficiary is borne by some bank, not by Originator. The most likely reason for noncompletion is a failure to execute or an erroneous execution of a payment order by Bank A or an intermediary bank. Bank A may have issued its payment order to the wrong bank or it may have identified the wrong beneficiary in its order. The money-back guarantee is particularly important to Originator if noncompletion of the funds transfer is due to the fault of an intermediary bank rather than Bank A. In that case Bank A must refund payment to Originator, and Bank A has the burden of obtaining refund from the intermediary bank that it paid.

Subsection (c) can result in loss if an intermediary bank suspends payments. Suppose Originator instructs Bank A to pay to Beneficiary's account in Bank B and to use Bank C as an intermediary bank. Bank A executes Originator's order by issuing a payment order to Bank C. Bank A pays Bank C. Bank C fails to execute the order of Bank A and suspends payments. Under subsections (c) and (d), Originator is not obliged to pay Bank A and is entitled to refund from Bank A of any payment that it may have made. Bank A is entitled to a refund from Bank C, but Bank C is insolvent. Subsection (e) deals with this case. Bank A was required to issue its payment order to Bank C because Bank C was designated as an intermediary bank by Originator. Section 4A-302(a)(1). In this case Originator takes the risk of insolvency of Bank C. Under subsection (e), Bank A is entitled to payment from Originator and Originator is subrogated to the right of Bank A under subsection (d) to refund of payment from Bank C.

3. A payment order is not like a negotiable instrument on which the drawer or maker has liability. Acceptance of the order by the receiving bank creates an obligation of the sender to pay the receiving bank the amount of the order. That is the extent of the sender's liability to the receiving bank and no other person has any rights against the sender with respect to the sender's order.

§ 25-4A-403. Payment by sender to receiving bank.

(a) Payment of the sender's obligation under G.S. 25-4A-402 to pay the receiving bank occurs as follows:

(1) If the sender is a bank, payment occurs when the receiving bank receives final settlement of the obligation through a Federal Reserve Bank or through a funds-transfer system.

(2) If the sender is a bank and the sender (i) credited an account of the receiving bank with the sender, or (ii) caused an account of the receiving bank in another bank to be credited, payment occurs when the credit is withdrawn or, if not withdrawn, at midnight of the day on which the credit is withdrawable and the receiving bank learns of that fact.

(3) If the receiving bank debits an account of the sender with the receiving bank, payment occurs when the debit is made to the extent the debit is covered by a withdrawable credit balance in the account.

(b) If the sender and receiving bank are members of a funds-transfer system that nets obligations multilaterally among participants, the receiving bank receives final settlement when settlement is complete in accordance with the rules of the system. The obligation of the sender to pay the amount of a payment order transmitted through the funds-transfer system may be satisfied, to the extent permitted by the rules of the system, by setting off and applying against the sender's obligation the right of the sender to receive payment from the receiving bank of the amount of any other payment order transmitted to the sender by the receiving bank through the funds-transfer system. The aggregate balance of obligations owed by each sender to each receiving bank in the funds-transfer system may be satisfied, to the extent permitted by the rules of the system, by setting off and applying against that balance the aggregate balance of obligations owed to the sender by other members of the system. The aggregate balance is determined after the right of setoff stated in the second sentence of this subsection has been exercised.

(c) If two banks transmit payment orders to each other under an agreement that settlement of the obligations of each bank to the other under G.S. 25-4A-402 will be made at the end of the day or other period, the total amount owed with respect to all orders transmitted by one bank shall be set off against the total amount owed with respect to all orders transmitted by the other bank. To the extent of the setoff, each bank has made payment to the other.

(d) In a case not covered by subsection (a), the time when payment of the sender's obligation under G.S. 25-4A-402(b) or G.S. 25-4A-402(c) occurs is governed by applicable principles of law that determine when an obligation is satisfied. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. This section defines when a sender pays the obligation stated in Section 4A-402. If a group of two or more banks engage in funds transfers with each other, the participating banks will sometimes be senders and sometimes receiving banks. With respect to payment orders other than Fedwires, the amounts of the various payment orders may be credited and debited to accounts of one bank with another or to a clearing house account of each bank and amounts owed and amounts due are netted. Settlement is made through a Federal Reserve Bank by charges to the Federal Reserve accounts of the net debtor banks and credits to the Federal Reserve accounts of the net creditor banks. In the case of Fedwires the sender's obligation is settled by a debit to the Federal Reserve account of the sender and a credit to the Federal Reserve account of the receiving bank at the time the receiving bank receives the payment order. Both of these cases are covered by subsection (a)(1). When the Federal Reserve settlement becomes final the obligation of the sender under Section 4A-402 is paid.

2. In some cases a bank does not settle an obligation owed to another bank through a Federal Reserve Bank. This is the case if one of the banks is a foreign bank without access to the Federal Reserve payment system. In this kind of case, payment is usually made by credits or debits to accounts of the two banks with each other or to accounts of the two banks in a third bank. Suppose Bank B has an account in Bank A. Bank A advises Bank B that its account in Bank A has been credited $1,000,000 and that the credit is immediately withdrawable. Bank A also instructs Bank B to pay $1,000,000 to the account of Beneficiary in Bank B. This case is covered by subsection (a)(2). Bank B may want to immediately withdraw this credit. For example, it might do so by instructing Bank A to debit the account and pay some third party. Payment by Bank A to Bank B of Bank A's payment order occurs when the withdrawal is made. Suppose Bank B does not withdraw the

credit. Since Bank B is the beneficiary's bank, one of the effects of receipt of payment by Bank B is that acceptance of Bank A's payment order automatically occurs at the time of payment. Section 4A-209(b)(2). Acceptance means that Bank B is obliged to pay $1,000,000 to Beneficiary. Section 4A-404(a). Subsection (a)(2) of Section 4A-403 states that payment does not occur until midnight if the credit is not withdrawn. This allows Bank B an opportunity to reject the order if it does not have time to withdraw the credit to its account and it is not willing to incur the liability to Beneficiary before it has use of the funds represented by the credit.

3. Subsection (a)(3) applies to a case in which the sender (bank or nonbank) has a funded account in the receiving bank. If Sender has an account in Bank and issues a payment order to Bank, Bank can obtain payment from Sender by debiting the account of Sender, which pays its Section 4A-402 obligation to Bank when the debit is made.

4. Subsection (b) deals with multilateral settlements made through a funds transfer system and is based on the CHIPS settlement system. In a funds transfer system such as CHIPS, which allows the various banks that transmit payment orders over the system to settle obligations at the end of each day, settlement is not based on individual payment orders. Each bank using the system engages in funds transfers with many other banks using the system. Settlement for any participant is based on the net credit or debit position of that participant with all other banks using the system. Subsection (b) is designed to make clear that the obligations of any sender are paid when the net position of that sender is settled in accordance with the rules of the funds transfer system. This provision is intended to invalidate any argument, based on common-law principles, that multilateral netting is not valid because mutuality of obligation is not present. Subsection (b) dispenses with any mutuality of obligation requirements. Subsection (c) applies to cases in which two banks send payment orders to each other during the day and settle with each other at the end of the day or at the end of some other period. It is similar to subsection (b) in that it recognizes that a sender's obligation to pay a payment order is satisfied by a setoff. The obligations of each bank as sender to the other as receiving bank are obligations of the bank itself and not as representative of customers. These two sections are important in the case of insolvency of a bank. They make clear that liability under Section 4A-402 is based on the net position of the insolvent bank after setoff.

5. Subsection (d) relates to the uncommon case in which the sender doesn't have an account relationship with the receiving bank and doesn't settle through a Federal Reserve Bank. An example would be a customer that pays over the counter for a payment order that the customer issues to the receiving bank. Payment would normally be by cash, check or bank obligation. When payment occurs is determined by law outside Article 4A.

§ 25-4A-404. Obligation of beneficiary's bank to pay and give notice to beneficiary.

(a) Subject to G.S. 25-4A-211(e), 25-4A-405(d), and 25-4A-405(e), if a beneficiary's bank accepts a payment order, the bank is obliged to pay the amount of the order to the beneficiary of the order. Payment is due on the payment date of the order, but if acceptance occurs on the payment date after the close of the funds-transfer business day of the bank, payment is due on the next funds-transfer business day. If the bank refuses to pay after demand by the beneficiary and receipt of notice of particular circumstances that will give rise to consequential damages as a result of nonpayment, the beneficiary may recover damages resulting from the refusal to pay to the extent the bank had notice of the damages, unless the bank proves that it did not pay because of a reasonable doubt concerning the right of the beneficiary to payment.

(b) If a payment order accepted by the beneficiary's bank instructs payment to an account of the beneficiary, the bank is obliged to notify the beneficiary of receipt of the order before midnight of the next funds-transfer business day following the payment date. If the payment order does not instruct payment to an account of the beneficiary, the bank is required to notify the beneficiary only if notice is required by the order. Notice may be given by first-class mail or any other means reasonable in the circumstances. If the bank fails to give the required notice, the bank is obliged to pay interest to the beneficiary on the amount of the payment order from the day notice should have been given until the day the beneficiary learned of receipt of the payment order by the bank. No other damages are recoverable. Reasonable attorneys' fees are also recoverable if demand for interest is made and refused before an action is brought on the claim.

(c) The right of a beneficiary to receive payment and damages as stated in subsection (a) may not be varied by agreement or a funds-transfer system rule. The right of a beneficiary to be notified as stated in subsection (b) may be varied by agreement of the beneficiary or by a funds-transfer system rule if the beneficiary is notified of the rule before initiation of the funds transfer. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. The first sentence of subsection (a) states the time when the obligation of the beneficiary's bank arises. The second and third sentences state when the beneficiary's bank must make funds available to the beneficiary. They also state the measure of damages for failure, after demand, to comply. Since the Expedited Funds Availability Act, 12 U.S.C. 4001 et seq., also governs funds availability in a funds transfer, the second and third sentences of subsection (a) may be subject to preemption by that Act.

2. Subsection (a) provides that the beneficiary of an accepted payment order may recover consequential damages if the beneficiary's bank refuses to pay the order after demand by the beneficiary if the bank at that time had notice of the particular circumstances giving rise to the damages. Such damages are recoverable only to the extent the bank had "notice of the damages." The quoted phrase requires that the bank have notice of the general type or nature of the damages that will be suffered as a result of the refusal to pay and their general magnitude. There is no requirement that the bank have notice of the exact or even the approximate amount of the damages, but if the amount of damages is extraordinary the bank is entitled to notice of that fact. For example, in Evra Corp. v. Swiss Bank Corp., 673 F.2d 951 (7th Cir. 1982), failure to complete a funds transfer of only $27,000 required to retain rights to a very favorable ship charter resulted in a claim for more than $2,000,000 of consequential damages. Since it is not reasonably foreseeable that a failure to make a relatively small payment will result in damages of this magnitude, notice is not sufficient if the beneficiary's bank has notice only that the $27,000 is necessary to retain rights on a ship charter. The bank is entitled to notice that an exceptional amount of damages will result as well. For example, there would be adequate notice if the bank had been made aware that damages of $1,000,000 or more might result.

3. Under the last clause of subsection (a) the beneficiary's bank is not liable for damages if its refusal to pay was "because of a reasonable doubt concerning the right of the beneficiary to payment." Normally there will not be any question about the right of the beneficiary to receive payment. Normally, the bank should be able to determine whether it has accepted the payment order and, if it has been accepted, the first sentence of subsection (a) states that the bank is obliged to pay. There may be uncommon cases, however, in which there is doubt whether acceptance occurred. For example, if acceptance is based on receipt of payment by the beneficiary's bank under Section 4A-403 (a)(1) or (2), there may be cases in which the bank is not certain that payment has been received. There may also be cases in which there is doubt about whether the person demanding payment is the person identi-

fied in the payment order as beneficiary of the order.

The last clause of subsection (a) does not apply to cases in which a funds transfer is being used to pay an obligation and a dispute arises between the originator and the beneficiary concerning whether the obligation is in fact owed. For example, the originator may try to prevent payment to the beneficiary by the beneficiary's bank by alleging that the beneficiary is not entitled to payment because of fraud against the originator or a breach of contract relating to the obligation. The fraud or breach of contract claim of the originator may be grounds for recovery by the originator from the beneficiary after the beneficiary is paid, but it does not affect the obligation of the beneficiary's bank to pay the beneficiary. Unless the payment order has been cancelled pursuant to Section 4A-211(c), there is no excuse for refusing to pay the beneficiary and, in a proper case, the refusal may result in consequential damages. Except in the case of a book transfer, in which the beneficiary's bank is also the originator's bank, the originator of a funds transfer cannot cancel a payment order to the beneficiary's bank, with or without the consent of that bank, because the originator is not the sender of that order. Thus, the beneficiary's bank may safely ignore any instruction by the originator to withhold payment to the beneficiary.

4. Subsection (b) states the duty of the beneficiary's bank to notify the beneficiary of receipt of the order. If acceptance occurs under Section 4A-209(b)(1) the beneficiary is normally notified. Thus, subsection (b) applies primarily to cases in which acceptance occurs under Section 4A-209(b)(2) or (3). Notice under subsection (b) is not required if the person entitled to the notice agrees or a funds transfer system rule provides that notice is not required and the beneficiary is given notice of the rule. In ACH transactions the normal practice is not to give notice to the beneficiary unless notice is requested by the beneficiary. This practice can be continued by adoption of a funds transfer system rule. Subsection (a) is not subject to variation by agreement or by a funds transfer system rule.

§ 25-4A-405. Payment by beneficiary's bank to beneficiary.

(a) If the beneficiary's bank credits an account of the beneficiary of a payment order, payment of the bank's obligation under G.S. 25-4A-404(a) occurs when and to the extent (i) the beneficiary is notified of the right to withdraw the credit, (ii) the bank lawfully applies the credit to a debt of the beneficiary, or (iii) funds with respect to the order are otherwise made available to the beneficiary by the bank.

(b) If the beneficiary's bank does not credit an account of the beneficiary of a payment order, the time when payment of the bank's obligation under G.S. 25-4A-404(a) occurs is governed by principles of law that determine when an obligation is satisfied.

(c) Except as stated in subsections (d) and (e), if the beneficiary's bank pays the beneficiary of a payment order under a condition to payment or agreement of the beneficiary giving the bank the right to recover payment from the beneficiary if the bank does not receive payment of the order, the condition to payment or agreement is not enforceable.

(d) A funds-transfer system rule may provide that payments made to beneficiaries of funds transfers made through the system are provisional until receipt of payment by the beneficiary's bank of the payment order it accepted. A beneficiary's bank that makes a payment that is provisional under the rule is entitled to refund from the beneficiary if (i) the rule requires that both the beneficiary and the originator be given notice of the provisional nature of the payment before the funds transfer is initiated, (ii) the beneficiary, the beneficiary's bank, and the originator's bank agreed to be bound by the rule, and (iii) the beneficiary's bank did not receive payment of the payment order that it accepted. If the beneficiary is obliged to refund payment to the beneficiary's bank, acceptance of the payment order by the beneficiary's bank is nullified and no payment by the originator of the funds transfer to the beneficiary occurs under G.S. 25-4A-406.

(e) This subsection applies to a funds transfer that includes a payment order transmitted over a funds-transfer system that (i) nets obligations multilaterally among participants, and (ii) has in effect a loss-sharing agreement among participants for the purpose of providing funds necessary to complete settlement of the obligations of one or more participants that do not meet their settlement obligations. If the beneficiary's bank in the funds transfer accepts a payment order and the system fails to complete settlement pursuant to its rules with respect to any payment order in the funds transfer, (i) the acceptance by the beneficiary's bank is nullified and no person has any right or obligation based on the acceptance, (ii) the beneficiary's bank is entitled to recover payment from the beneficiary, (iii) no payment by the originator to the beneficiary occurs under G.S. 25-4A-406, and (iv) subject to G.S. 25-4A-402(e), each sender in the funds transfer is excused from its obligation to pay its payment order under G.S. 25-4A-402(c) because the funds transfer has not been completed. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. This section defines when the beneficiary's bank pays the beneficiary and when the obligation of the beneficiary's bank under Section 4A-404 to pay the beneficiary is satisfied. In almost all cases the bank will credit an account of the beneficiary when it receives a payment order. In the typical case the beneficiary is paid when the beneficiary is given notice of the right to withdraw the credit. Subsection (a)(i). In some cases payment might be made to the beneficiary not by releasing funds to the beneficiary, but by applying the credit to a debt of the beneficiary. Subsection (a)(ii). In this case the beneficiary gets the benefit of the payment order because a debt of the beneficiary has been satisfied. The two principal cases in which payment will occur in this manner are setoff by the beneficiary's bank and payment of the proceeds of the payment order to a garnishing creditor of the beneficiary. These cases are discussed in Comment 2 to Section 4A-502.

2. If a beneficiary's bank releases funds to the beneficiary before it receives payment from the sender of the payment order, it assumes the risk that the sender may not pay the sender's order because of suspension of payments or other reason. Subsection (c). As stated in Comment 5 to Section 4A-209, the beneficiary's bank can protect itself against this risk by delaying acceptance. But if the bank accepts the order it is obliged to pay the beneficiary. If the beneficiary's bank has given the beneficiary notice of the right to withdraw a credit made to the beneficiary's account, the beneficiary has received payment from the bank. Once payment has been made to the beneficiary with respect to an obligation incurred by the bank under Section 4A-404(a), the payment cannot be recovered by the beneficiary's bank unless subsection (d) or (e) applies. Thus, a right to withdraw a credit cannot be revoked if the right to withdraw constituted payment of the bank's obligation. This principle applies even if funds were released as a "loan" (see Comment 5 to Section 4A-209), or were released subject to a condition that they would be repaid in the event the bank does not receive payment from the sender of the payment order, or the beneficiary agreed to return the payment if the bank did not receive payment from the sender.

3. Subsection (c) is subject to an exception stated in subsection (d) which is intended to apply to automated clearing house transfers. ACH transfers are

made in batches. A beneficiary's bank will normally accept, at the same time and as part of a single batch, payment orders with respect to many different originator's banks. Comment 2 to Section 4A-206. The custom in ACH transactions is to release funds to the beneficiary early on the payment date even though settlement to the beneficiary's bank does not occur until later in the day. The understanding is that payments to beneficiaries are provisional until the beneficiary's bank receives settlement. This practice is similar to what happens when a depositary bank releases funds with respect to a check forwarded for collection. If the check is dishonored the bank is entitled to recover the funds from the customer. ACH transfers are widely perceived as check substitutes. Section 4A-405(d) allows the funds transfer system to adopt a rule making payments to beneficiaries provisional. If such a rule is adopted, a beneficiary's bank that releases funds to the beneficiary will be able to recover the payment if it doesn't receive payment of the payment order that it accepted. There are two requirements with respect to the funds transfer system rule. The beneficiary, the beneficiary's bank and the originator's bank must all agree to be bound by the rule and the rule must require that both the beneficiary and the originator be given notice of the provisional nature of the payment before the funds transfer is initiated. There is no requirement that the notice be given with respect to a particular funds transfer. Once notice of the provisional nature of the payment has been given, the notice is effective for all subsequent payment to or from the person to whom the notice was given. Subsection (d) provides only that the funds transfer system rule must require notice to the beneficiary and the originator. The beneficiary's bank will know what the rule requires, but it has no way of knowing whether the originator's bank complied with the rule. Subsection (d) does not require proof that the originator received notice. If the originator's bank failed to give the required notice and the originator suffered as a result, the appropriate remedy is an action by the originator against the originator's bank based on that failure. But the beneficiary's bank will not be able to get the benefit of subsection (d) unless the beneficiary had notice of the provisional nature of the payment because subsection (d) requires an agreement by the beneficiary to be bound by the rule. Implicit in an agreement to be bound by a rule that makes a payment provisional is a requirement that notice be given of what the rule provides. The notice can be part of the agreement or separately given. For example, notice can be given by providing a copy of the system's operating rules.

With respect to ACH transfers made through a Federal Reserve Bank acting as an intermediary bank, the Federal Reserve Bank is obliged under Section 4A-402(b) to pay a beneficiary's bank that accepts the payment order. Unlike Fedwire transfers, under current ACH practice a Federal Reserve Bank that processes a payment order does not obligate itself to pay if the originator's bank fails to pay the Federal Reserve Bank. It is assumed that the Federal Reserve will use its right of preemption which is recognized in Section 4A-107 to disclaim the Section 4A-402(b) obligation in ACH transactions if it decides to retain the provisional payment rule.

4. Subsection (e) is another exception to subsection (c). It refers to funds transfer systems having loss-sharing rules described in the subsection. CHIPS has proposed a rule that fits the description. Under the CHIPS loss-sharing rule the CHIPS banks will have agreed to contribute funds to allow the system to settle for payment orders sent over the system during the day in the event that one or more banks are unable to meet their settlement obligations. Subsection (e) applies only if CHIPS fails to settle despite the loss-sharing rule. Since funds under the loss-sharing rule will be instantly available to CHIPS and will be in an amount sufficient to cover any failure that can be reasonably anticipated, it is extremely unlikely that CHIPS would ever fail to settle. Thus, subsection (e) addresses an event that should never occur. If that event were to occur, all payment orders made over the system would be cancelled under the CHIPS rule. Thus, no bank would receive settlement, whether or not a failed bank was involved in a particular funds transfer. Subsection (e) provides that each funds transfer in which there is a payment order with respect to which there is a settlement failure is unwound. Acceptance by the beneficiary's bank in each funds transfer is nullified. The consequences of nullification are that the beneficiary has no right to receive or retain payment by the beneficiary's bank,

no payment is made by the originator to the beneficiary and each sender in the funds transfer is, subject to Section 4A-402(e), not obliged to pay its payment order and is entitled to refund under Section 4A-402(d) if it has already paid.

§ 25-4A-406. Payment by originator to beneficiary; discharge of underlying obligation.

(a) Subject to G.S. 25-4A-211(e), 25-4A-405(d), and 25-4A-405(e), the originator of a funds transfer pays the beneficiary of the originator's payment order (i) at the time a payment order for the benefit of the beneficiary is accepted by the beneficiary's bank in the funds transfer and (ii) in an amount equal to the amount of the order accepted by the beneficiary's bank, but not more than the amount of the originator's order.

(b) If payment under subsection (a) is made to satisfy an obligation, the obligation is discharged to the same extent discharge would result from payment to the beneficiary of the same amount in money, unless (i) the payment under subsection (a) was made by a means prohibited by the contract of the beneficiary with respect to the obligation, (ii) the beneficiary, within a reasonable time after receiving notice of receipt of the order by the beneficiary's bank, notified the originator of the beneficiary's refusal of the payment, (iii) funds with respect to the order were not withdrawn by the beneficiary or applied to a debt of the beneficiary, and (iv) the beneficiary would suffer a loss that could reasonably have been avoided if payment had been made by a means complying with the contract. If payment by the originator does not result in discharge under this section, the originator is subrogated to the rights of the beneficiary to receive payment from the beneficiary's bank under G.S. 25-4A-404(a).

(c) For the purpose of determining whether discharge of an obligation occurs under subsection (b), if the beneficiary's bank accepts a payment order in an amount equal to the amount of the originator's payment order less charges of one or more receiving banks in the funds transfer, payment to the beneficiary is deemed to be in the amount of the originator's order unless upon demand by the beneficiary the originator does not pay the beneficiary the amount of the deducted charges.

(d) Rights of the originator or of the beneficiary of a funds transfer under this section may be varied only by agreement of the originator and the beneficiary. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) states the fundamental rule of Article 4A that payment by the originator to the beneficiary is accomplished by providing to the beneficiary the obligation of the beneficiary's bank to pay. Since this obligation arises when the beneficiary's bank accepts a payment order, the originator pays the beneficiary at the time of acceptance and in the amount of the payment order accepted.

2. In a large percentage of funds transfers, the transfer is made to pay an obligation of the originator. Subsection (a) states that the beneficiary is paid by the originator when the beneficiary's bank accepts a payment order for the benefit of the beneficiary. When that happens the effect under subsection (b) is to substitute the obligation of the beneficiary's bank for the obligation of the originator. The effect is similar to that under Article 3 if a cashier's check payable to the beneficiary had been taken by the bene-

ficiary. Normally, payment by funds transfer is sought by the beneficiary because it puts money into the hands of the beneficiary more quickly. As a practical matter the beneficiary and the originator will nearly always agree to the funds transfer in advance. Under subsection (b) acceptance by the beneficiary's bank will result in discharge of the obligation for which payment was made unless the beneficiary had made a contract with respect to the obligation which did not permit payment by the means used. Thus, if there is no contract of the beneficiary with respect to the means of payment of the obligation, acceptance by the beneficiary's bank of a payment order to the account of the beneficiary can result in discharge.

3. Suppose Beneficiary's contract stated that payment of an obligation owed by Originator was to be made by a cashier's check of Bank A. Instead Originator paid by a funds transfer to Beneficiary's account in Bank B. Bank B accepted a payment order for the benefit of Beneficiary by immediately notifying Beneficiary that the funds were available for withdrawal. Before Beneficiary had a reasonable opportunity to withdraw the funds Bank B suspended payments. Under the unless clause of subsection (b) Beneficiary is not required to accept the payment as discharging the obligation owed by Originator to Beneficiary if Beneficiary's contract means that Beneficiary was not required to accept payment by wire transfer. Beneficiary could refuse the funds transfer as payment of the obligation and could resort to rights under the underlying contract to enforce the obligation. The rationale is that Originator cannot impose the risk of Bank B's insolvency on Beneficiary if Beneficiary had specified another means of payment that did not entail that risk. If Beneficiary is required to accept Originator's payment, Beneficiary would suffer a loss that would not have occurred if payment had been made by a cashier's check on Bank A, and Bank A has not suspended payments. In this case Originator will have to pay twice. It is obliged to pay the amount of its payment order to the bank that accepted it and has to pay the obligation it owes to Beneficiary which has not been discharged. Under the last sentence of subsection (b) Originator is subrogated to Beneficiary's right to receive payment from Bank B under Section 4A-404(a).

4. Suppose Beneficiary's contract called for payment by a Fedwire transfer to Bank B, but the payment order accepted by Bank B was not a Fedwire transfer. Before the funds were withdrawn by Beneficiary, Bank B suspended payments. The sender of the payment order to Bank B paid the amount of the order to Bank B. In this case the payment order by Originator did not comply with Beneficiary's contract, but the noncompliance did not result in a loss to Beneficiary as required by subsection (b)(iv). A Fedwire transfer avoids the risk of insolvency of the sender of the payment order to Bank B, but it does not affect the risk that Bank B will suspend payments before withdrawal of the funds by Beneficiary. Thus, the unless clause of subsection (b) is not applicable and the obligation owed to Beneficiary is discharged.

5. Charges of receiving banks in a funds transfer normally are nominal in relationship to the amount being paid by the originator to the beneficiary. Wire transfers are normally agreed to in advance and the parties may agree concerning how these charges are to be divided between the parties. Subsection (c) states a rule that applies in the absence of agreement. In some funds transfers charges of banks that execute payment orders are collected by deducting the charges from the amount of the payment order issued by the bank, i.e. the bank issues a payment order that is slightly less than the amount of the payment order that is being executed. The process is described in Comment 3 to Section 4A-302. The result in such a case is that the payment order accepted by the beneficiary's bank will be slightly less than the amount of the originator's order. Subsection (c) recognizes the principle that a beneficiary is entitled to full payment of a debt paid by wire transfer as a condition to discharge. On the other hand, subsection (c) prevents a beneficiary from denying the originator the benefit of the payment by asserting that discharge did not occur because deduction of bank charges resulted in less than full payment. The typical case is one in which the payment is made to exercise a valuable right such as an option which is unfavorable to the beneficiary. Subsection (c) allows discharge notwithstanding the deduction unless the originator fails to reimburse the beneficiary for the deducted charges after demand by the beneficiary.

PART 5.

MISCELLANEOUS PROVISIONS.

§ 25-4A-501. Variation by agreement and effect of funds-transfer system rule.

(a) Except as otherwise provided in this Article, the rights and obligations of a party to a funds transfer may be varied by agreement of the affected party.

(b) "Funds-transfer system rule" means a rule of an association of banks (i) governing transmission of payment orders by means of a funds-transfer system of the association or rights and obligations with respect to those orders, or (ii) to the extent the rule governs rights and obligations between banks that are parties to a funds transfer in which a Federal Reserve Bank, acting as an intermediary bank, sends a payment order to the beneficiary's bank. Except as otherwise provided in this Article, a funds-transfer system rule governing rights and obligations between participating banks using the system may be effective even if the rule conflicts with this Article and indirectly affects another party to the funds transfer who does not consent to the rule. A funds-transfer system rule may also govern rights and obligations of parties other than participating banks using the system to the extent stated in G.S. 25-4A-404(c), 25-4A-405(d), and 25-4A-507(c). (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. This section is designed to give some flexibility to Article 4A. Funds transfer system rules govern rights and obligations between banks that use the system. They may cover a wide variety of matters such as form and content of payment orders, security procedures, cancellation rights and procedures, indemnity rights, compensation rules for delays in completion of a funds transfer, time and method of settlement, credit restrictions with respect to senders of payment orders and risk allocation with respect to suspension of payments by a participating bank. Funds transfer system rules can be very effective in supplementing the provisions of Article 4A and in filling gaps that may be present in Article 4A. To the extent they do not conflict with Article 4A there is no problem with respect to their effectiveness. In that case they merely supplement Article 4A. Section 4A-501 goes further. It states that unless the contrary is stated, funds transfer system rules can override provisions of Article 4A. Thus, rights and obligations of a sender bank and a receiving bank with respect to each other can be different from that stated in Article 4A to the extent a funds transfer system rule applies. Since funds transfer system rules are defined as those governing the relationship between participating banks, a rule can have have a direct effect only on participating banks. But a rule that affects the conduct of a participating bank may indirectly affect the rights of nonparticipants such as the originator or beneficiary of a funds transfer, and such a rule can be effective even though it may affect nonparticipants without their consent. For example, a rule might prevent execution of a payment order or might allow cancellation of a payment order with the result that a funds transfer is not completed or is delayed. But a rule purporting to define rights and obligations of nonparticipants in the system would not be effective to alter Article 4A rights because the rule is not within the definition of funds transfer system rule. Rights and obligations arising under Article 4A may also be varied by agreement of the affected parties, except to the extent Article 4A otherwise provides. Rights and obligations arising under Article 4A can also be changed by Federal Reserve regulations and operating circulars of Federal Reserve Banks. Section 4A-107.

2. Subsection (b)(ii) refers to ACH transfers. Whether an ACH transfer is made through an automated clearing house of a Federal Reserve Bank or through an automated clearing house of another association of banks, the rights and obligations of the originator's bank and the beneficiary's bank are governed by uniform rules adopted by various associations of banks in various parts of the nation. With respect to transfers in which a Federal Reserve Bank acts as intermediary bank these rules may be incorporated, in whole or in part, in operating circulars of the Federal Reserve Bank. Even if not so incorporated these rules can still be binding on the association banks. If a transfer is made through a Federal Reserve Bank, the rules are effective under subsection (b)(ii). If the transfer is not made through a Federal Reserve Bank, the association rules are effective under subsection (b)(i).

§ 25-4A-502. Creditor process served on receiving bank; setoff by beneficiary's bank.

(a) As used in this section, "creditor process" means levy, attachment, garnishment, notice of lien, sequestration, or similar process issued by or on behalf of a creditor or other claimant with respect to an account.

(b) This subsection applies to creditor process with respect to an authorized account of the sender of a payment order if the creditor process is served on the receiving bank. For the purpose of determining rights with respect to the creditor process, if the receiving bank accepts the payment order the balance in the authorized account is deemed to be reduced by the amount of the payment order to the extent the bank did not otherwise receive payment of the order, unless the creditor process is served at a time and in a manner affording the bank a reasonable opportunity to act on it before the bank accepts the payment order.

(c) If a beneficiary's bank has received a payment order for payment to the beneficiary's account in the bank, the following rules apply:

(1) The bank may credit the beneficiary's account. The amount credited may be set off against an obligation owed by the beneficiary to the bank or may be applied to satisfy creditor process served on the bank with respect to the account.

(2) The bank may credit the beneficiary's account and allow withdrawal of the amount credited unless creditor process with respect to the account is served at a time and in a manner affording the bank a reasonable opportunity to act to prevent withdrawal.

(3) If creditor process with respect to the beneficiary's account has been served and the bank has had a reasonable opportunity to act on it, the bank may not reject the payment order except for a reason unrelated to the service of process.

(d) Creditor process with respect to a payment by the originator to the beneficiary pursuant to a funds transfer may be served only on the beneficiary's bank with respect to the debt owed by that bank to the beneficiary. Any other bank served with the creditor process is not obliged to act with respect to the process. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. When a receiving bank accepts a payment order, the bank normally receives payment from the sender by debiting an authorized account of the sender. In accepting the sender's order the bank may be relying on a credit balance in the account. If creditor process is served on the bank with respect to the account before the bank accepts the order but the bank employee responsible for the acceptance was not aware of the creditor process at the time the acceptance occurred, it is unjust to the bank to allow the creditor process to take the credit balance on which the bank may have relied. Subsection (b) allows the bank to obtain payment form the sender's account in this case. Under that provision, the balance in the sender's account to which the creditor process applies is deemed to be reduced by the amount of the payment order unless there was sufficient time for notice of the service of creditor process to be received by personnel of the bank responsible for the acceptance.

2. Subsection (c) deals with payment orders issued to the beneficiary's bank. The bank may credit the beneficiary's account when the order is received, but under Section 4A-404(a) the bank incurs no obligation to pay the beneficiary until the order is accepted pursuant to Section 4A-209(b). Thus, before acceptance, the credit to the beneficiary's account is provisional. But under Section 4A-209(b) acceptance occurs if the beneficiary's bank pays the beneficiary pursuant to Section 4A-405(a). Under that provision, payment occurs if the credit to the beneficiary's account is applied to a debt of the beneficiary. Subsection (c)(1) allows the bank to credit the beneficiary's account with respect to a payment order and to accept the order by setting off the credit against an obligation owed to the bank or applying the credit to creditor process with respect to the account.

Suppose a beneficiary's bank receives a payment order for the benefit of a customer. Before the bank accepts the order, the bank learns that creditor process has been served on the bank with respect to the customer's account. Normally there is no reason for a beneficiary's bank to reject a payment order, but if the beneficiary's account is garnished, the bank may be faced with a difficult choice. If it rejects the order, the garnishing creditor's potential recovery of funds of the beneficiary is frustrated. It may be faced with a claim by the creditor that the rejection was a wrong to the creditor. If the bank accepts the order, the effect is to allow the creditor to seize funds of its customer, the beneficiary. Subsection (c)(3) gives the bank no choice in this case. It provides that it may not favor its customer over the creditor by rejecting the order. The beneficiary's bank may rightfully reject only if there is an independent basis for rejection.

3. Subsection (c)(2) is similar to subsection (b). Normally the beneficiary's bank will release funds to the beneficiary shortly after acceptance or it will accept by releasing funds. Since the bank is bound by a garnishment order served before funds are released to the beneficiary, the bank might suffer a loss if funds were released without knowledge that a garnishment order had been served. Subsection (c)(2) protects the bank if it did not have adequate notice of the garnishment when the funds were released.

4. A creditor may want to reach funds involved in a funds transfer. The creditor may try to do so by serving process on the originator's bank, an intermediary bank or the beneficiary's bank. The purpose of subsection (d) is to guide the creditor and the court as to the proper method of reaching the funds involved in a funds transfer. A creditor of the originator can levy on the account of the originator in the originator's bank before the funds transfer is initiated, but that levy is subject to the limitations stated in subsection (b). The creditor of the originator cannot reach any other funds because no property of the originator is being transferred. A creditor of the beneficiary cannot levy on property of the originator and until the funds transfer is completed by acceptance by the beneficiary's bank of a payment order for the benefit of the beneficiary, the beneficiary has no property interest in the funds transfer which the beneficiary's creditor can reach. A creditor of the beneficiary that wants to reach the funds to be received by the beneficiary must serve creditor process on the beneficiary's bank to reach the obligation of the beneficiary's bank to pay the beneficiary which arises upon acceptance by

the beneficiary's bank under Section 4A-404(a).

5. "Creditor process" is defined in subsection (a) to cover a variety of devices by which a creditor of the holder of a bank account or a claimant to a bank account can seize the account. Procedure and nomenclature varies widely from state to state. The term used in Section 4A-502 is a generic term.

§ 25-4A-503. Injunction or restraining order with respect to funds transfer.

For proper cause and in compliance with applicable law, a court may restrain (i) a person from issuing a payment order to initiate a funds transfer, (ii) an originator's bank from executing the payment order of the originator, or (iii) the beneficiary's bank from releasing funds to the beneficiary or the beneficiary from withdrawing the funds. A court may not otherwise restrain a person from issuing a payment order, paying or receiving payment of a payment order, or otherwise acting with respect to a funds transfer. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

This section is related to Section 4A-502(d) and to Comment 4 to Section 4A-502. It is designed to prevent interruption of a funds transfer after it has been set in motion. The initiation of a funds transfer can be prevented by enjoining the originator or the originator's bank from issuing a payment order. After the funds transfer is completed by acceptance of a payment order by the beneficiary's bank, that bank can be enjoined from releasing funds to the beneficiary or the beneficiary can be enjoined from withdrawing the funds. No other injunction is permitted. In particular, intermediary banks are protected, and injunctions against the originator and the originator's bank are limited to issuance of a payment order. Except for the beneficiary's bank, nobody can be enjoined from paying a payment order, and no receiving bank can be enjoined from receiving payment from the sender of the order that it accepted.

§ 25-4A-504. Order in which items and payment orders may be charged to account; order of withdrawals from account.

(a) If a receiving bank has received more than one payment order of the sender or one or more payment orders and other items that are payable from the sender's account, the bank may charge the sender's account with respect to the various orders and items in any sequence.

(b) In determining whether a credit to an account has been withdrawn by the holder of the account or applied to a debt of the holder of the account, credits first made to the account are first withdrawn or applied. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) concerns priority among various obligations that are to be paid from the same account. A customer may have written checks on its account with the receiving bank and may have issued one or more payment orders payable from the same account. If the account balance is not sufficient to cover all of the checks and payment orders, some checks may be dishonored and some payment orders may not be accepted. Although there is no concept of wrongful dishonor of a payment order in Article 4A in the absence of an agree-

ment to honor by the receiving bank, some rights and obligations may depend on the amount in the customer's account. Section 4A-209(b)(3) and Section 4A-210(b). Whether dishonor of a check is wrongful also may depend upon the balance in the customer's account. Under subsection (a), the bank is not required to consider the competing items and payment orders in any particular order. Rather it may charge the customer's account for the various items and orders in any order. Suppose there is $12,000 in the customer's account. If a check for $5,000 is presented for payment and the bank receives a $10,000 payment order from the customer, the bank could dishonor the check and accept the payment order. Dishonor of the check is not wrongful because the account balance was less than the amount of the check after the bank charged the account $10,000 on account of the payment order. Or, the bank could pay the check and not execute the payment order because the amount of the order is not covered by the balance in the account.

2. Subsection (b) follows Section 4-208(b) in using the first-in-first-out rule for determining the order in which credits to an account are withdrawn.

§ 25-4A-505. Preclusion of objection to debit of customer's account.

If a receiving bank has received payment from its customer with respect to a payment order issued in the name of the customer as sender and accepted by the bank, and the customer received notification reasonably identifying the order, the customer is precluded from asserting that the bank is not entitled to retain the payment unless the customer notifies the bank of the customer's objection to the payment within one year after the notification was received by the customer. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

This section is in the nature of a statute of repose for objecting to debits made to the customer's account. A receiving bank that executes payment orders of a customer may have received payment from the customer by debiting the customer's account with respect to a payment order that the customer was not required to pay. For example, the payment order may not have been authorized or verified pursuant to Section 4A-202 or the funds transfer may not have been completed. In either case the receiving bank is obliged to refund the payment to the customer and this obligation to refund payment cannot be varied by agreement. Section 4A-204 and Section 4A-402. Refund may also be required if the receiving bank is not entitled to payment from the customer because the bank erroneously executed a payment order. Section 4A-303. A similar analysis applies to that case. Section 4A-402(d) and (f) require refund and the obligation to refund may not be varied by agreement. Under 4A-505, however, the obligation to refund may not be asserted by the customer if the customer has not objected to the debiting of the account within one year after the customer received notification of the debit.

§ 25-4A-506. Rate of interest.

(a) If, under this Article, a receiving bank is obliged to pay interest with respect to a payment order issued to the bank, the amount payable may be determined (i) by agreement of the sender and receiving bank, or (ii) by a funds-transfer system rule if the payment order is transmitted through a funds-transfer system.

(b) If the amount of interest is not determined by an agreement or rule as stated in subsection (a), the amount is calculated by multiplying the applicable federal funds rate by the amount on which interest is payable, and then multiplying the product by the number of days for which interest is payable. The applicable federal funds rate is the average of the federal funds rates published by the Federal Reserve Bank of New York for each of the days for which interest is payable divided by 360. The federal funds rate for any day on which a published rate is not available is the same as the published rate for the next preceding day for which there is a published rate. If a receiving bank that accepted a payment order is required to refund payment to the sender of the order because the funds transfer was not completed, but the failure to complete was not due to any fault by the bank, the interest payable is reduced by a percentage equal to the reserve requirement on deposits of the receiving bank. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. A receiving bank is required to pay interest on the amount of a payment order received by the bank in a number of situations. Sometimes the interest is payable to the sender and in other cases it is payable to either the originator or the beneficiary of the funds transfer. The relevant provisions are Section 4A-204(a), Section 4A-209(b)(3), Section 4A-210(b), Section 4A-305(a), Section 4A-402(d) and Section 4A-404(b). The rate of interest may be governed by a funds transfer system rule or by agreement as stated in subsection (a). If subsection (a) doesn't apply, the rate is determined under subsection (b). Subsection (b) is illustrated by the following example. A bank is obliged to pay interest on $1,000,000 for three days, July 3, July 4, and July 5. The published Fed Funds rate is .082 for July 3 and .081 for July 5. There is no published rate for July 4 because that day is not a banking day. The rate for July 3 applies to July 4. The applicable Fed Funds rate is .08167 (the average of .082, .082, and .081) divided by 360 which equals .0002268. The amount of interest payable is $1,000,000 X .0002268 X 3 = $680.40.

2. In some cases, interest is payable in spite of the fact that there is no fault by the receiving bank. The last sentence of subsection (b) applies to those cases. For example, a funds transfer might not be completed because the beneficiary's bank rejected the payment order issued to it by the originator's bank or an intermediary bank. Section 4A-402(c) provides that the originator is not obliged to pay its payment order and Section 4A-402(d) provides that the originator's bank must refund any payment received plus interest. The requirement to pay interest in this case is not based on fault by the originator's bank. Rather, it is based on restitution. Since the originator's bank had the use of the originator's money, it is required to pay the originator for the value of that use. The value of that use is not determined by multiplying the interest rate by the refundable amount because the originator's bank is required to deposit with the Federal Reserve a percentage of the bank's deposits as a reserve requirement. Since that deposit does not bear interest, the bank had use of the refundable amount reduced by a percentage equal to the reserve requirement. If the reserve requirement is 12%, the amount of interest payable by the bank under the formula stated in subsection (b) is reduced by 12%.

§ 25-4A-507. Choice of law.

(a) The following rules apply unless the affected parties otherwise agree or subsection (c) applies:

(1) The rights and obligations between the sender of a payment order and the receiving bank are governed by the law of the jurisdiction in which the receiving bank is located.

(2) The rights and obligations between the beneficiary's bank and the beneficiary are governed by the law of the jurisdiction in which the beneficiary's bank is located.

(3) The issue of when payment is made pursuant to a funds transfer by the originator to the beneficiary is governed by the law of the jurisdiction in which the beneficiary's bank is located.

(b) If the parties described in each paragraph of subsection (a) have made an agreement selecting the law of a particular jurisdiction to govern rights and obligations between each other, the law of that jurisdiction governs those rights and obligations, whether or not the payment order or the funds transfer bears a reasonable relation to that jurisdiction.

(c) A funds-transfer system rule may select the law of a particular jurisdiction to govern (i) rights and obligations between participating banks with respect to payment orders transmitted or processed through the system, or (ii) the rights and obligations of some or all parties to a funds transfer any part of which is carried out by means of the system. A choice of law made pursuant to clause (i) is binding on participating banks. A choice of law made pursuant to clause (ii) is binding on the originator, other sender, or a receiving bank having notice that the funds-transfer system might be used in the funds transfer and of the choice of law by the system when the originator, other sender, or receiving bank issued or accepted a payment order. The beneficiary of a funds transfer is bound by the choice of law if, when the funds transfer is initiated, the beneficiary has notice that the funds-transfer system might be used in the funds transfer and of the choice of law by the system. The law of a jurisdiction selected pursuant to this subsection may govern, whether or not that law bears a reasonable relation to the matter in issue.

(d) In the event of inconsistency between an agreement under subsection (b) and a choice-of-law rule under subsection (c), the agreement under subsection (b) prevails.

(e) If a funds transfer is made by use of more than one funds-transfer system and there is inconsistency between choice-of-law rules of the systems, the matter in issue is governed by the law of the selected jurisdiction that has the most significant relationship to the matter in issue. (1993, c. 157, s. 1.)

OFFICIAL COMMENT

1. Funds transfers are typically interstate or international in character. If part of a funds transfer is governed by Article 4A and another part is governed by other law, the rights and obligations of parties to the funds transfer may be unclear because there is no clear consensus in various jurisdictions concerning the juridical nature of the transaction. Unless all of a funds transfer is governed by a single law it may be very difficult to predict the result if something goes wrong in the transfer. Section 4A-507 deals with this problem. Subsection (b) allows parties to a funds transfer to make a choice-of-law agreement. Subsection (c) allows a funds transfer system to select the law of a particular jurisdiction to govern funds transfers carried out by means of the system. Subsection (a) states residual rules if no choice of law has occurred under subsection (b) or (c).

2. Subsection (a) deals with three sets of relationships. Rights and obligations between the sender of a payment order and the receiving bank are governed by the law of the jurisdiction in which the receiving bank is located. If the receiving bank is the beneficiary's bank the rights and obligations of the beneficiary are also governed by the law of the jurisdiction in which the receiving bank is located. Suppose Originator, located in Canada, sends a payment order to Originator's Bank located in a state in which Article 4A has been enacted. The order is for payment to an account of Benefi-

ciary in a bank in England. Under subsection (a)(1), the rights and obligations of Originator and Originator's Bank toward each other are governed by Article 4A if an action is brought in a court in the Article 4A state. If an action is brought in a Canadian court, the conflict of laws issue will be determined by Canadian law which might or might not apply the law of the state in which Originator's Bank is located. If that law is applied, the execution of Originator's order will be governed by Article 4A, but with respect to the payment order of Originator's Bank to the English bank, Article 4A may or may not be applied with respect to the rights and obligations between the two banks. The result may depend upon whether action is brought in a court in the state in which Originator's Bank is located or in an English court. Article 4A is binding only on a court in a state that enacts it. It can have extraterritorial effect only to the extent courts of another jurisdiction are willing to apply it. Subsection (c) also bears on the issues discussed in this Comment.

Under Section 4A-406 payment by the originator to the beneficiary of the funds transfer occurs when the beneficiary's bank accepts a payment order for the benefit of the beneficiary. A jurisdiction in which Article 4A is not in effect may follow a different rule or it may not have a clear rule. Under Section 4A-507(a)(3) the issue is governed by the law of the jurisdiction in which the beneficiary's bank is located. Since the payment to the beneficiary is made through the beneficiary's bank it is reasonable that the issue of when payment occurs be governed by the law of the jurisdiction in which the bank is located. Since it is difficult in many cases to determine where a beneficiary is located, the location of the beneficiary's bank provides a more certain rule.

3. Subsection (b) deals with choice-of-law agreements and it gives maximum freedom of choice. Since the law of funds transfers is not highly developed in the case law there may be a strong incentive to choose the law of a jurisdiction in which Article 4A is in effect because it provides a greater degree of certainty with respect to the rights of various parties. With respect to commercial transactions, it is often said that "[u]niformity and predictability based upon commercial convenience are the prime considerations in making the choice of governing law ...." R. Leflar, American Conflicts Law, § 185 (1977). Subsection (b) is derived in part from recently enacted choice-of-law rules in the States of New York and California. N.Y. Gen. Obligations Law 5-1401 (McKinney's 1989 Supp.) and California Civil Code § 1646.5. This broad endorsement of freedom of contract is an enhancement of the approach taken by Restatement (Second) of Conflict of Laws § 187(b) (1971). The Restatement recognizes the basic right of freedom of contract, but the freedom granted the parties may be more limited than the freedom granted here. Under the formulation of the Restatement, if there is no substantial relationship to the jurisdiction whose law is selected and there is no "other" reasonable basis for the parties' choice, then the selection of the parties need not be honored by a court. Further, if the choice is violative of a fundamental policy of a state which has a materially greater interest than the chosen state, the selection could be disregarded by a court. Those limitations are not found in subsection (b).

4. Subsection (c) may be the most important provision in regard to creating uniformity of law in funds transfers. Most rights stated in Article 4A regard parties who are in privity of contract such as originator and beneficiary, sender and receiving bank, and beneficiary's bank and beneficiary. Since they are in privity they can make a choice of law by agreement. But that is not always the case. For example, an intermediary bank that improperly executes a payment order is not in privity with either the originator or the beneficiary. The ability of a funds transfer system to make a choice of law by rule is a convenient way of dispensing with individual agreements and to cover cases in which agreements are not feasible. It is probable that funds transfer systems will adopt a governing law to increase the certainty of commercial transactions that are effected over such systems. A system rule might adopt the law of an Article 4A state to govern transfers on the system in order to provide a consistent, unitary, law governing all transfers made on the system. To the extent such system rules develop, individual choice-of-law agreements become unnecessary.

Subsection (c) has broad application. A system choice of law applies not only to rights and obligations between banks that use the system, but may also apply to other parties to the funds transfer so long as some part of the transfer was carried out over the system. The originator and any other sender or receiving bank in the funds transfer is bound if at the time it issues or accepts a payment order it had notice that the funds transfer involved use of the system and that the system chose the law of a particular jurisdiction. Under Section 4A-107, the Federal Reserve by regulation could make a similar choice of law to govern funds transfers carried out by use of Federal Reserve Banks. Subsection (d) is a limitation on subsection (c). If parties have made a choice-of-law agreement that conflicts with a choice of law made under subsection (c), the agreement prevails.

5. Subsection (e) addresses the case in which a funds transfer involves more than one funds transfer system and the systems adopt conflicting choice-of-law rules. The rule that has the most significant relationship to the matter at issue prevails. For example, each system should be able to make a choice of law governing payment orders transmitted over that system without regard to a choice of law made by another system.

ARTICLE 5.

Letters of Credit.

§ 25-5-101. Short title.

Legal Periodicals. — For article, "Letters Of Credit: A North Carolina Primer," see 24 Wake Forest L. Rev. 653 (1989).

§ 25-5-102. Scope.

CASE NOTES

Stipulation Held Agreement to Agree Rather Than Enforceable Guaranty. — Stipulation provision entered into in exchange for plaintiff banks' consent to stay foreclosure, which stated that defendant bank would issue a standby letter of credit in favor of plaintiffs, as beneficiaries, was a mere agreement to agree, rather than an enforceable contract of guaranty, where until defendant's issuer and principals, the mortgagors, formed underlying preliminary contract, no letter of credit contract could issue, and the provision left open and unsettled the future formation of the requisite preliminary contract between defendant and mortgagors, and provided no mode of ensuring execution thereof. Mountain Fed. Land Bank v. First Union Nat'l Bank, 98 N.C. App. 195, 390 S.E.2d 679, cert. denied, 327 N.C. 141, 394 S.E.2d 178 (1990).

§ 25-5-103. Definitions.

CASE NOTES

Stipulation Held Agreement to Agree Rather Than Guaranty. — Stipulation provision entered into in exchange for plaintiffs banks' consent to stay foreclosure, which stated that defendant bank would issue a standby letter of credit in favor of plaintiffs, as beneficiaries, was a mere agreement to agree, rather than an enforceable contract of guaranty, where until defendant's issuer and principals the mortgagors formed underlying preliminary contract, no letter of credit contract could issue, and the provision left open and unsettled the future formation of the requisite preliminary contract between defendant and mortgagors, and provided no mode of ensuring execution thereof. Mountain Fed. Land Bank v. First Union Nat'l Bank, 98 N.C. App. 195, 390 S.E.2d 679, cert. denied, 327 N.C. 141, 394 S.E.2d 178 (1990).

Quoted in Northwestern Bank v. NCF Fin. Corp., 88 N.C. App. 614, 365 S.E.2d 14 (1988).

§ 25-5-114. Issuer's duty and privilege to honor; right to reimbursement.

(1) An issuer must honor a draft or demand for payment which complies with the terms of the relevant credit regardless of whether the goods or documents conform to the underlying contract for sale or other contract between the customer and the beneficiary. The issuer is not excused from honor of such a draft or demand by reason of an additional general term that all documents must be satisfactory to the issuer, but an issuer may require that specified documents must be satisfactory to it.

(2) Unless otherwise agreed when documents appear on their face to comply with the terms of a credit but a required document does not in fact conform to the warranties made on negotiation or transfer of a document of title (G.S. 25-7-507) or of a certificated security (G.S. 25-8-306) or is forged or fraudulent or there is fraud in the transaction

(a) the issuer must honor the draft or demand for payment if honor is demanded by a negotiating bank or other holder of the draft or demand which has taken the draft or demand under the credit and under circumstances which would make it a holder in due course (G.S. 25-3-302) and in an appropriate case would make it a person to whom a document of title has been duly negotiated (G.S. 25-7-502) or a bona fide purchaser of a certificated security (G.S. 25-8-302); and

(b) in all other cases as against its customer, an issuer acting in good faith may honor the draft or demand for payment despite notification from the customer of fraud, forgery or other defect not apparent on the face of the documents but a court of appropriate jurisdiction may enjoin such honor.

(3) Unless otherwise agreed an issuer which has duly honored a draft or demand for payment is entitled to immediate reimbursement of any payment made under the credit and to be put in effectively available funds not later than the day before maturity of any acceptance made under the credit. (1965, c. 700, s. 1; 1989 (Reg. Sess., 1990), c. 1024, s. 8(d).)

Editor's Note. —
The amendment by 1989 (Reg. Sess., 1990), c. 1024, s. 8(d) is a conforming amendment to the amendments to Article 8 of this Chapter that were adopted in 1989.

Effect of Amendments. — The 1989 (Reg. Sess., 1990) amendment, effective July 27, 1990, inserted "certificated" preceding "security" in the introductory paragraph of subsection (2) and in subdivision (2)(a).

CASE NOTES

When Draft Must Be Honored. — With limited exceptions, this section imposes on the issuer a duty to honor drafts where there has been compliance with the terms of credit. Northwestern Bank v. NCF Fin. Corp., 88 N.C. App. 614, 365 S.E.2d 14 (1988).

Exceptions to Issuer's Duty Concern Genuineness of Documents. — The exceptions to the issuer's duty to honor documents which on their face comply with the terms of the credit concern merely the genuineness of the documents presented for honor. Northwestern Bank v. NCF Fin. Corp., 88 N.C. App. 614, 365 S.E.2d 14 (1988).

Knowledge on Part of Beneficiary of Fraudulent Procurement of Letter of Credit. — It may be argued that where a beneficiary extends a loan relying on a letter of credit which he knows was procured through fraud on the issuer, the statement of default of the underlying loan is a product of the fraud entitling the issuer to one of the exceptions to the issuer's duty to honor. However, the beneficiary must have known of the fraudulent procurement of the letter of credit at the time it extended credit based on the letter as collateral. Northwestern Bank v. NCF Fin. Corp., 88 N.C. App. 614, 365 S.E.2d 14 (1988).

Beneficiary's Right Not Affected by Requirement Which Was Not a Term of Letter of Credit. — While the beneficiary must strictly comply with the terms of a letter of credit in order to make a demand from the issuer, where plaintiff beneficiary complied with terms of letter of credit, and delivered required certified statement to issuer, any requirement of demand on customers was not a term of the letter of credit and did not affect plaintiff beneficiary's right to present a draft on the letter of credit. Northwestern Bank v. NCF Fin. Corp., 88 N.C. App. 614, 365 S.E.2d 14 (1988).

ARTICLE 6.

Bulk Transfers.

§ 25-6-103. Transfers excepted from this article.

CASE NOTES

Under the Uniform Commercial Code default is a prerequisite for settlement or realization of a security interest. Sutton Woodworking Mach. Co. v. DKLS, Inc., 113 N.C. App. 649, 439 S.E.2d 806 (1994).

A common requirement for exemption by subsection (3) is that the transferor must be in default. Sutton Woodworking Mach. Co. v. DKLS, Inc., 113 N.C. App. 649, 439 S.E.2d 806 (1994).

§ 25-6-107. The notice.

CASE NOTES

Applied in Pendergrass v. Card Care, Inc., 333 N.C. 233, 424 S.E.2d 391 (1993).

ARTICLE 7.

Warehouse Receipts, Bills of Lading and Other Documents of Title.

PART 2.

WAREHOUSE RECEIPTS: SPECIAL PROVISIONS.

§ 25-7-202. Form of warehouse receipt; essential terms; optional terms.

CASE NOTES

"Household Goods Descriptive Inventory" was sufficient to constitute a warehouse receipt for purposes of holding defendant moving company responsible under Art. 7 for its actions as a warehouseman where the document listed each item picked up, its condition, the owner's name, the original loading address, and was signed and dated by defendant's authorized agent and driver. Tate v. Action Moving & Storage, Inc., 95 N.C. App. 541, 383 S.E.2d 229 (1989).

§ 25-7-204. Duty of care; contractual limitation of warehouseman's liability.

CASE NOTES

Irregularity in Warehouse Receipt. — Even though "Household Goods Descriptive Inventory" was probably irregular as a warehouse receipt, this irregularity did not relieve defendant of his duty to act as a reasonably careful person in relation to plaintiff's goods. Tate v. Action Moving & Storage, Inc., 95 N.C. App. 541, 383 S.E.2d 229 (1989).

§ 25-7-209. Lien of warehouseman.

CASE NOTES

Quoted in Tate v. Action Moving & Storage, Inc., 95 N.C. App. 541, 383 S.E.2d 229 (1989).

§ 25-7-210. Enforcement of warehouseman's lien.

CASE NOTES

Failure to Comply with Subsection (3) Constituted Conversion. — Where defendant moving company refused to accept payment by plaintiff and continued to hold goods while mounting up storage fees, and even though plaintiff effectively satisfied the lien on his goods by giving defendant $4,800.00, defendant sold the goods, defendant's failure to comply with the requirements of subsection (3) constituted a willful violation of the requirements for sale, and the defendant was properly held liable for conversion of plaintiff's goods. Tate v. Action Moving & Storage, Inc., 95 N.C. App. 541, 383 S.E.2d 229 (1989), cert. denied, 326 N.C. 54, 389 S.E.2d 104 (1990).

PART 4.

WAREHOUSE RECEIPTS AND BILLS OF LADING: GENERAL OBLIGATIONS.

§ 25-7-401. Irregularities in issue of receipt or bill or conduct of issuer.

CASE NOTES

Warehouse Receipt. — Even though "Household Goods Descriptive Inventory" was probably irregular as a warehouse receipt, this irregularity did not relieve defendant of his duty to act as a reasonably careful person in relation to plaintiff's goods. Tate v. Action Moving & Storage, Inc., 95 N.C. App. 541, 383 S.E.2d 229 (1989).

ARTICLE 8.

Investment Securities.

Editor's Note. — Amended Official Comments in Article 8: Copyright 1977 by The American Law Institute and the National Conference of Commissioners on Uniform State Laws. Reprinted with the permission of the Permanent Editorial Board for the Uniform Commercial Code.

NORTH CAROLINA INTRODUCTORY COMMENT TO THE 1989 AMENDMENTS TO ARTICLE 8

Article 8 of Chapter 25 of the General Statutes was substantially revised in 1989 to adopt the revision to Article 8 of the Uniform Commercial Code which has been approved in 1977 by the National Conference of Commissioners on Uniform State Laws (the "1977 Revision") providing rules governing certificateless, or uncertificated, securities. The 1989 amendments to Article 8 of Chapter 25 reflect only minor changes from the 1977 Revision.

PART 1.

SHORT TITLE AND GENERAL MATTERS.

§ 25-8-101. Short title.

AMENDED OFFICIAL COMMENT

Purposes:

This Article sets forth certain rights and duties of the issuers of and the parties that deal with investment securities, both certificated and uncertificated. Unlike a corporation code, it does not set forth general rules defining property rights that accrue to holders of securities. And unlike a Blue Sky statute it does not set forth specific requirements for disclosing to the public the nature of the property interest that is the security. Rather it sets forth rules relative to the transfer of the rights that constitute securities and to the establishment of those rights against the issuer and other parties.

As is true with respect to all other Articles of the Code, parties may be agreement create rights and duties between themselves that vary from those set forth in this Article. Section 1-102(3). But prejudice to the rights of those not party to the agreement is limited by

Code provisions (*e.g.*, Sections 8-313 and 8-321) as well as by general legal principles that supplement the Code. See Section 1-103 and Comment 2 to Section 1-102.

This Article does not purport to determine whether a particular issue of securities should be represented by certificates, in whole or in part. That determination is left to the parties involved, subject to federal and state law.

Legal Periodicals. —

For comment, "Fraud-on-the-Market Theory and Thinly-Traded Securities Under Rule 10b-5: How Does a Court Decide If a Stock Market Is Efficient?", see 25 Wake Forest L. Rev. 223 (1990).

For note, "Close Corporation Stock as a 'Security' Under Uniform Commercial Code Article 8: North Carolina Embraces the Statute of Frauds in Stancil v. Stancil," see 69 N.C.L. Rev. 1432 (1991).

§ 25-8-102. Definitions and index of definitions.

(1) In this Article, unless the context otherwise requires:

(a) A "certificated security" is a share, participation, or other interest in property of or an enterprise of the issuer or an obligation of the issuer which is:

(i) Represented by an instrument issued in bearer or registered form,

(ii) Of a type commonly dealt in on securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment, and

(iii) Either one of a class or series or by its terms divisible into a class or series of shares, participations, interests, or obligations.

(b) An "uncertificated security" means a share, participation, or other interest in property or an enterprise of the issuer or an obligation of the issuer which is:

(i) Not represented by an instrument and the transfer of which is registered upon books maintained for that purpose by or on behalf of the issuer,

(ii) Of a type commonly dealt in on securities exchanges or markets,

(iii) Either one of a class or series or by its terms divisible into a class or series of shares, participations, interest, or obligations, and

(iv) Not a partnership interest in a limited partnership, unless the partnership interest is approved for trading on a national securities exchange registered under the federal securities laws or for quotation in the automated quotation system of a national securities association registered under the federal securities laws.

(c) A "security" is either a certificated or an uncertificated security. If a security is certificated, the terms "security" and "certificated security" may mean either the intangible interest, the instrument representing that interest, or both, as the context requires. A writing that is a certificated security is governed by this article and not by Uniform Commercial Code — Commercial Paper, even though it also meets the requirements of that article. This Article does not apply to money. If a certificated security has been retained by or surrendered to the issuer or its transfer agent for reasons other than registration of transfer, other temporary purpose, payment, exchange, or acquisition by the issuer, that security shall be treated as an uncertificated security for purposes of this article.

(d) A certificated security is in “registered form” if

(i) It specifies a person entitled to the security or the rights it represents, and

(ii) Its transfer may be registered upon books maintained for that purpose by or on behalf of the issuer, or the security so states.

(e) A certificated security is in “bearer form” if it runs to bearer according to its terms and not by reason of any indorsement.

(2) A “subsequent purchaser” is a person who takes other than by original issue.

(3) A “clearing corporation” is a corporation registered as a “clearing agency” under the federal securities laws or a corporation:

(a) At least ninety percent (90%) of whose capital stock is held by or for one or more organizations, none of which, other than a national securities exchange or association, holds in excess of twenty percent (20%) of the capital stock of the corporation, and each of which is (i) subject to supervision or regulation pursuant to the provisions of federal or State banking laws or State insurance laws, (ii) a broker or dealer or investment company registered under the federal securities laws, or (iii) a national securities exchange or association registered under the federal securities laws; and

(b) Any remaining capital stock of which is held by individuals who have purchased it at or prior to the time of their taking office as directors of the corporation and who have purchased only so much of the capital stock as is necessary to permit them to qualify as directors.

(4) A “custodian bank” is a bank or trust company that is supervised and examined by State or federal authority having supervision over banks and is acting as custodian for a clearing corporation.

(5) Other definitions applying to this Article or to specified parts thereof and the sections in which they appear are:

“Adverse claim”.	G.S. 25-8-302
“Bona fide purchaser”.	G.S. 25-8-302
“Broker”.	G.S. 25-8-303
“Debtor”.	G.S. 25-9-105
“Financial intermediary”.	G.S. 25-8-313
“Guarantee of the signature”.	G.S. 25-8-402
“Initial transaction statement”.	G.S. 25-8-408
“Instruction”.	G.S. 25-8-308
“Intermediary bank”.	G.S. 25-4-105
“Issuer”.	G.S. 25-8-201
“Overissue”.	G.S. 25-8-104
“Secured Party”.	G.S. 25-9-105
“Security Agreement”.	G.S. 25-9-105

(6) In addition, Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article. (1965, c. 700, s. 1; 1973, c. 497, s. 3; 1989, c. 588, s. 1; 1989 (Reg. Sess., 1990), c. 1024, s. 9(a).)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. This is Article 8's definitional Section. It is supplemented generally by the definitions in Article 1 and in particular matters is supplemented by definitions in other Articles. Subsection (5) enumerates several important supplementary definitions and their locations in the Code.

2. Subsection (1) defines "security," the basic term of this section. Paragraphs (a) and (b) respectively define "certificated security" and "uncertificated security," and paragraph (c) states that the term "security" comprises both. These definitions are functional rather than formal. At the core is the notion that a security is a share or participation in an enterprise or an obligation that is of a type commonly traded in organized markets for such interests or is commonly recognized as a medium for investment. The ambit of the definition will change as "securities" trading practices evolve to include or exclude new property interests. It is believed that the definition will cover anything which securities markets, including not only the organized exchanges but as well the "over-the-counter" markets, are likely to regard as suitable for trading. For example, transferable warrants evidencing rights to subscribe for shares in a corporation will normally be "certificated securities" within the definition, since they (a) are issued in bearer or registered form, (b) are of a type commonly dealt in on securities markets, (c) constitute a class or series of instruments, and (d) evidence an obligation of the issuer, namely the obligation to honor the warrant upon its due exercise and issue shares accordingly.

Notice that the definition of uncertificated security does not include the phrase "or commonly recognized in any area in which it is issued or dealt in as a medium for investment." Since there is no requirement of representation by an instrument, a great many interests that might be regarded as media for investment would be classified as securities under the umbrella of the omitted phrase. For example, interests such as bank checking and savings accounts are intended to be excluded from the definition because they are not commonly traded; but since those accounts are commonly recognized as media for investment, the omitted language might bring them within the scope of the definition.

Interests such as the stock of closely-held corporations, although they are not actually traded upon securities exchanges, are intended to be included within the definitions of both certificated and uncertificated securities by the inclusion of interests "of a type" commonly traded in those markets. See paragraphs (1)(a)(ii) and (1)(b)(ii).

The second sentence of (1)(c) is intended to eliminate confusion arising from the fact that certificated securities are alternatively viewed as the actual pieces of paper and the interests they represent. The final sentence of (1)(c) is to recognize that an issuer that nominally issues certificated securities but does not normally send the certificates to the owners is functionally identical to the issuer of uncertificated securities and should be guided by the same rules.

3. The consequence of determining that an interest is a "security" is that this Article will provide the relative rights of issuers, owners, purchasers and creditors as to transfer of rights, notice of claims, registration of interests, etc. This definition has no bearing upon whether an interest is a "security" for purposes of federal securities laws. By the same token the definitions of "securities" for purposes of those laws has no bearing upon whether an interest is a security within the definition of this Article.

4. A certificated security is a negotiable instrument (Section 8-105) but is nonetheless governed by this Article rather than by Article 3. A critical distinction between certificated securities and other negotiable instruments is that one indorsing a security does not undertake the issuer's obligation or make any warranty that the issuer will honor the underlying obligation. One indorsing other negotiable instruments becomes secondarily liable on the underlying obligation.

5. The definition of "clearing corporation" in subsection (3) reflects the fact that a 1975 amendment to the Securities Exchange Act provides for registration of "clearing agencies" with the Securities and Exchange Commission.

Cross Reference:
Section 3-103.

Definitional Cross References:
"Bearer". Section 1-201.
"Issuer". Section 8-201.
"Money". Section 1-201.
"Person". Section 1-201.
"Rights". Section 1-201.
"Term". Section 1-201.
"Writing". Section 1-201.

NORTH CAROLINA COMMENT TO THE 1989 AMENDMENT

The definition of an "uncertificated security" adopted by the General Assembly in 1989 varies somewhat from the definition of an "uncertificated security" in the 1977 Revision by the addition of subdivision (1)(b)(iv), which excludes from this definition limited partnership interests which are not traded on a national securities exchange or quoted in an automated quotations system such as the National Association of Securities Dealers Automated Quotations System. This variation was considered to be desirable in order to avoid imposing on North Carolina partnerships obligations, such as those regarding issuance of initial transaction statements, which are not otherwise required by the North Carolina Revised Uniform Limited Partnership Act. For limited partnership interests which are not traded on an active market, the requirements of North Carolina partnership law were considered sufficient. The need for uniform rules governing the transfer and pledge of publicly traded limited partnership interests was considered to be greater, and, however, such interests remain subject to the provisions of Article 8.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, rewrote this section.

The 1989 (Reg. Sess., 1990) amendment, effective July 27, 1990, in subdivision (1)(b), deleted "and" at the end of clause (ii) and substituted ", and" for a period at the end of clause (iii).

CASE NOTES

Shares of Close Corporation Securities. — Shares of stock in closely held corporation are investment "securities" under the definition of that term in subdivision(1)(a) of this section. Stancil v. Stancil, 326 N.C. 766, 392 S.E.2d 373 (1990).

Cited in First Union Nat'l Bank v. Brendle's Stores, Inc., 165 Bankr. 811 (M.D.N.C. 1993).

§ 25-8-103. Issuer's lien.

A lien upon a security in favor of an issuer thereof is valid against a purchaser only if:

(a) The security is certificated and the right of the issuer to the lien is noted conspicuously thereon; or

(b) The security is uncertificated and a notation of the right of the issuer to the lien is contained in the initial transaction statement sent to the purchaser or, if his interest is transferred to him other than by registration of transfer, pledge, or release, the initial transaction statement sent to the registered owner or the registered pledgee. (1941, c. 353, s. 15; G.S., s. 55-95; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 15, Uniform Stock Transfer Act.

Purposes:

1. The rule of Section 15 of the Uniform Stock Transfer Act is made applicable to all securities covered by the Article. An analogous rule as to restrictions on transfer imposed by the issuer appears at Section 8-204. Compare also Section 8-202. This section differs from those two sections in that the purchaser's knowledge of the issuer's claim is irrelevant.

"Noted" makes clear that the text of the lien provisions need not be set forth in full. However, this would not override a provision of an applicable corporation code requiring statement *in haec verba*.

2. The purchaser of an uncertificated security is charged with notice of all provisions in the initial transaction statement, whether or not it is sent to him personally. Similarly, one who takes a certificated security is charged with notice of all provisions noted on the certificate whether or not he actually receives the certificate. When a purchaser takes a security under circumstances in which no initial transaction statement is sent to him by the issuer and no certificated security is delivered to him, he must look to the person to whom a transfer or pledge of the uncertificated security has been registered or the person in possession of the certificated security for the appropriate notice or absence thereof. If the purchaser is not notified of a lien he may have a right of action for breach of transfer warranties. See Section 8-306. Compare Section 8-202 and its Comment 1.

Cross References:

Sections 8-202 and 8-204.

Definitional Cross References:

"Certificated Security". Section 8-102.

"Conspicuous". Section 1-201.

"Initial Transaction Statement". Section 8-408.

"Issuer". Section 8-201.

"Purchaser". Section 1-201.

"Security". Section 8-102.

"Uncertificated Security". Section 8-102.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, substituted the present section for the former section which read: "A lien upon a security in favor of an issuer thereof is valid against a purchaser only if the right of the issuer to such lien is noted conspicuously on the security."

§ 25-8-104. Effect of overissue; "overissue."

(1) The provisions of this Article which validate a security or compel its issue or reissue do not apply to the extent that validation, issue or reissue would result in overissue; but if

(a) An identical security which does not constitute an overissue is reasonably available for purchase, the person entitled to issue or validation may compel the issuer to purchase the security for him and either to deliver a certificated security or to register the transfer of an uncertificated security to him, against surrender of any certificated security he holds; or

(b) A security is not so available for purchase, the person entitled to issue or validation may recover from the issuer the price he or the last purchaser for value paid for it with interest from the date of his demand.

(2) "Overissue" means the issue of securities in excess of the amount which the issuer has corporate power to issue. (1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. Deeply embedded in corporation law is the conception that "corporate power" to issue securities stems from the statute, either general or special, under which the corporation is organized. Corporation codes universally require that the charter or articles of incorporation state, at least as to capital shares, maximum limits in terms of number of shares or total dollar capital. Historically, special incorporation statutes are similarly drawn and sometimes similarly limit the face amount of authorized debt securities. The theory is that issue of securities in excess of the authorized amounts is prohibited. See, for example, McWilliams v. Geddes & Moss Undertaking Co., 169 So. 894 (1936, La.); Crawford v. Twin City Oil Co., 216 Ala. 216, 113 So. 61 (1927); New York and New Haven R.R. Co. v. Schuyler, 34 N.Y. 30 (1865). This conception persists despite modern corporation codes under which, by action of directors and stockholders, additional shares can be authorized by charter amendment and thereafter issued. This section does not give a person entitled to validation, issue or reissue of a security, the right to compel amendment of the charter to authorize additional shares. Therefore, in a case where issue of an additional security would require charter amendment, the plaintiff is limited to the two alternate remedies set forth in paragraphs (a) and (b) of subsection (1).

2. Where an identical security is reasonably available for purchase, whether because traded on an organized market, or because one or more security owners may be willing to sell at a not unreasonable price, the issuer, although unable to issue additional shares, will be able to purchase them and may be compelled to follow that procedure. West v. Tintic Standard Mining Co., 71 Utah 158, 263 P. 490, 56 A.L.R. 1190 (1928).

Paragraph (1)(a) gives the issuer the choice to transfer either a certificated or an uncertificated security. As a practical matter the issuer will have the choice only when the securities of the issue involved are partly certificated and partly uncertificated; and in those circumstances section 8-407 gives the owner (or registered pledgee) the right to choose the form of the security. Thus the issuer likely will transfer a security of the form requested by the person entitled to the security.

3. The right to recover damages from an issuer who has permitted an overissue to occur is well settled. New York and New Haven R.R. Co. v. Schuyler, 34 N.Y. 30 (1865). The measure of such damages, however, has been open to question, some courts basing them upon the value of stock at the time registration is refused; some upon the value at the time of trial; and some upon the highest value between the time of refusal and the time of trial. Allen v. South Boston Railroad, 150 Mass. 200, 22 N.E. 917, 5 L.R.A. 716, 15 Am.St.Rep. 185 (1889); Commercial Bank v. Kortright, 22 Wend. (N.Y.) 348 (1839). The purchase price of the security to the last purchaser who gave value for it is here adopted as being the fairest means of reducing the possibility of speculation by the purchaser. Interest may be recovered as the best available measure of compensation for delay.

4. This section modifies and controls the rules otherwise laid down in this Article as to the validation and issue of securities. The particular sections so modified are listed in the cross-references.

Cross References:

Point 4: See Sections 8-202, 8-205, 8-206, 8-208, 8-311 and Part 4 of this Article.

Definitional Cross References:

"Certificated Security". Section 8-102.
"Issuer". Section 8-201.
"Security". Section 8-102.
"Uncertificated Security". Section 8-102.
"Value". Section 1-201.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, in subsection (1), added "if" at the end of the introductory language; in subdivision (1)(a), deleted "if" preceding "An identical security," and substituted the language beginning "the security for him" for "and deliver such a security to him against surrender of the security, if any, which he holds;" and deleted "if" preceding "A security" in subdivision (1)(b).

§ 25-8-105. Certificated securities negotiable; statements and instructions not negotiable; presumptions.

(1) Certificated securities governed by this Article are negotiable instruments.

(2) Statements (G.S. 25-8-408), notices, or the like, sent by the issuer of uncertificated securities and instructions (G.S. 25-8-308) are neither negotiable instruments nor certificated securities.

(3) In any action on a security:

(a) Unless specifically denied in the pleadings, each signature on a certificated security in a necessary indorsement, on an initial transaction statement or on an instruction, is admitted;

(b) If the effectiveness of a signature is put in issue, the burden of establishing it is on the party claiming under the signature, but the signature is presumed to be genuine or authorized;

(c) If signatures on a certificated security are admitted or established, production of the security entitles a holder to recover on it unless the defendant establishes a defense or a defect going to the validity of the security;

(d) If signatures on an initial transaction statement are admitted or established, the facts stated in the statement are presumed to be true as of the time of its issuance; and

(e) After it is shown that a defense or defect exists, the plaintiff has the burden of establishing that he or some person under whom he claims is a person against whom the defense or defect is ineffective (G.S. 25-8-202). (1965, c. 700; s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. Although certificated securities are negotiable instruments, this Article and not Article 3 provides the rights and duties relative to such instruments. See Sections 8-102(1)(c) and 3-103(1). But in subsection (3) of this section the particular rules stated in Section 3-307 for the negotiable instruments governed by Article 3 are adapted to certificated securities. Further, those rules are adopted with respect to signatures on initial transaction statements, although subsection (2) makes clear that such statements are not negotiable instruments.

2. Paragraph (3)(d) makes clear that the effect of establishing the validity of signatures on an initial transaction statement is to create a presumption that the facts stated therein were true as of the time it was issued. The issuer is free to show that later events — e.g., a subsequent transfer — changed the stated facts.

3. "Any action on a security" includes any action or proceeding brought against the issuer to enforce a right or interest that is part of the security — e.g., to collect principal or interest or a dividend, or to establish a right to vote or to receive a new security under an exchange offer or plan of reorganization.

Cross References:

Sections 3-103, 3-307, 8-202, 8-301.

Definitional Cross References:

"Certificated Security". Section 8-102.

"Initial Transaction Statement". Section 8-408.

"Instruction". Section 8-308.

"Security". Section 8-102.
"Uncertificated Security". Section 8-102.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, substituted the present catchline for "Securities negotiable; presumptions;" and rewrote this section.

§ 25-8-106. Applicability.

The law (including the conflict of laws rules) of the jurisdiction of organization of the issuer governs the validity of a security, the effectiveness of registration by the issuer, and the rights and duties of the issuer with respect to:

(a) Registration of transfer of a certificated security;
(b) Registration of transfer, pledge, or release of an uncertificated security; and
(c) Sending of statements of uncertificated securities. (1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. This section states a special rule for conflicts of laws relating to certain matters covered by this Article. Except as provided in this section, the generally applicable conflicts rules stated in Section 1-105 apply to Article 8.

2. Generally speaking, this section makes the law, including the conflict of laws rules, of the jurisdiction in which the issuer is organized applicable to determine the rights and obligations of the issuer with respect to security. Further, the *effectiveness* of registration by the issuer is to be governed by the law of the jurisdiction in which the issuer is organized. Thus whenever an uncertificated security is transferred through registration on the issuer's records, Section 8-313(1)(b), this section provides the choice of law rule as to the effectiveness of the registration to effect the transfer. Similarly, the effectiveness of a registration on the issuer's records to create and perfect a security interest in uncertificated securities (see Section 8-321) is within the ambit of this section.

It is significant that this section makes applicable the conflict of laws rules as well as the substantive law of the jurisdiction in which the issuer is organized. Because of this provision many matters related to the registration of transfer — for example, the appointment of a guardian for an incompetent person and the existence of agency relations — may be governed by the substantive law of a jurisdiction other than that in which the issuer is organized.

Any transfer of securities that is not effected through registration on the issuer's records is subject to the law provided by general choice of law rules. Transfers (including pledges) of certificated securities are not effected by registration on the issuer's records, and thus are subject to general choice of law rules. Similarly, some transfers of uncertificated securities are not covered by this section. See Section 8-313(1)(d) and (f)-(j).

Cross References:

Sections 1-105 and 8-202 and Part 4 of this Article.

Definitional Cross References:

"Certificated Security". Section 8-102.
"Issuer". Section 8-201.
"Security". Section 8-102.
"Uncertificated Security". Section 8-102.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, rewrote this section.

§ 25-8-107. Securities transferable; action for price.

(1) Unless otherwise agreed and subject to any applicable law or regulation respecting short sales, a person obligated to transfer securities may transfer any certificated security of the specified issue in bearer form or registered in the name of the transferee or indorsed to him or in blank, or he may transfer an equivalent uncertificated security to the transferee or a person designated by the transferee.

(2) If the buyer fails to pay the price as it comes due under a contract of sale the seller may recover the price of

(a) Certificated securities accepted by the buyer;

(a1) Uncertificated securities that have been transferred to the buyer or a person designated by the buyer; and

(b) Other securities if efforts at their resale would be unduly burdensome or if there is no readily available market for their resale. (1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. The rights and interests that constitute securities of the same issue are "fungible". Section 1-201(17). This is true of both certificated and uncertificated securities. Subsection (1) states the generally accepted legal consequences of such fungibility. "Unless otherwise agreed", the seller, bailee, broker or other "person obligated to transfer securities" need not transfer any specific instrument, but may select (e. g., from "a fungible bulk" (Section 8-313(2)) any security of the proper issue, in bearer form or appropriately registered or indorsed, or may transfer an uncertificated security of the same issue.

Rules of the organized markets limiting the forms in which securities are transferable in transactions on such markets are matters "otherwise agreed". Cases such as Parsons v. Martin, 77 Mass. (11 Gray) 111 (1858) and Rumery v. Brooks, 205 App.Div. 283, 199 N.Y.Supp. 517 (1st Dept. 1923), holding a broker liable for conversion if he registers transfer of a customer's securities held in "cash account" out of the customer's name or tenders on demand for delivery a different though equivalent security, are rejected. However, this Act does not enlarge the rights of a broker as to such securities so as to permit him without the customer's consent to pledge them for his own indebtedness, as he may properly do with securities held in a "margin account" to the extent he has acquired a lien for advances. The distinction is carefully preserved in statute (e.g., N.Y.Penal Law § 956) and case law. In re Mills, 125 App.Div. 730, 110 N.Y.Supp. 314 (1st Dept. 1908).

2. Subsection (2) is designed to follow the dictum in Agar v. Orda, 264 N.Y. 248, 190 N.E. 479 (1934) in this context. Paragraph (c) is applicable where for example (i) the securities are those of a "closely-held" corporation not dealt in on any organized market; or (ii) because of the necessity for compliance with the registration requirements of the Securities Act of 1933 or other regulatory provisions or procedures prior to offering the particular securities on the market substantial delay and expense would be involved. The approval of these particular remedies does not constitute disapproval of other remedies that may exist under other rules of law. Section 1-103.

Cross References:

Sections 1-103; 2-708; 2-709; 8-313; 8-319.

Definitional Cross References:

"Action". Section 1-201.

"Certificated Security". Section 8-102.
"Contract". Section 1-201.
"Person". Section 1-201.
"Security". Section 8-102.
"Uncertificated Security". Section 8-102.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, substituted "transferable" for "deliverable" in the catchline; in subsection (1), substituted "transfer securities" for "deliver securities," "transfer any certificated security" for "deliver any security," and added the language beginning "or he may transfer an equivalent uncertificated security"; in subsection (2), in the introductory language, substituted "If" for "When," and added "of" at the end of the language, in subdivision (a), substituted "Certificated," for "of", and deleted "and" at the end of the subdivision, added subdivision (a1), and deleted "of" preceding "Other" in subdivision (b).

CASE NOTES

Failure to Cite This Section in Complaint No Bar to Remedy. — In an action by the sellers of securities under a contract for sale to recover the purchase price of securities not accepted by the buyer, sellers' failure to specifically cite this section in their complaint did not foreclose them from seeking the contract price remedy nor limit them to recovering only the more traditional measure of the difference between fair market value and unpaid contract price. Atkins v. Mitchell, 91 N.C. App. 730, 373 S.E.2d 152 (1988).

Determining Availability of Resale Market. — In an action by sellers of securities under a contract for sale to recover the purchase price of securities not accepted by the buyer, the question of whether efforts to resell the securities would be unduly burdensome or whether there was a readily available market for resale required weighing facts, rather than solely applying legal principles; therefore, it was a question to be resolved by a trier of fact. Atkins v. Mitchell, 91 N.C. App. 730, 373 S.E.2d 152 (1988).

§ 25-8-108. Registration of pledge and release of uncertificated securities.

A security interest in an uncertificated security may be evidenced by the registration of pledge to the secured party or a person designated by him. There may be no more than one registered pledge of an uncertificated security at any time. The registered owner of an uncertificated security is the person in whose name the security is registered, even if the security is subject to a registered pledge. The rights of a registered pledgee of an uncertificated security under this Article are terminated by the registration of release. (1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

This section introduces the concept of the registered pledge of uncertificated securities. The term "pledge" is used, notwithstanding the absence of physical delivery, because it reflects common terminology employed in connection with security interests in investment securities. Note that the same term has been used in Section 8-320 to describe the security interest created by book entry made by a securities depository. The rights of a registered pledgee, set forth in other sections (particularly Section 8-207), are intended to resemble, as closely as possible, the rights of the pledgee of a certificated security who retains possession of the pledged security without reregistration. Although the registration of pledge requires communication to the issuer, no details of the security agreement between the debtor and the secured party need be disclosed.

There is no provision for the registration of more than one pledge at a time. This limits the burden on issuers and insulates them from problems of conflicting priorities and the like. The registration of pledge is only one among several methods of creating security interests under Section 8-313(1), and other methods can be effectively employed to create security interests junior to that of the registered pledgee or even first security interests if, for some reason, the use of the registered pledge mechanism is inadvisable. See Section 8-321, which deals comprehensively with security interests and incorporates the transfer rules of Section 8-313(1) by reference.

The third sentence makes it clear that the registered owner, and not the registered pledgee, is the person in whose name an uncertificated security is registered as, for example, to determine how an unsecured creditor may reach his debtor's interest under Section 8-317(2). The registration of release, in effect, nullifies the registration of pledge, and is functionally equivalent to the redelivery of a pledged certificated security to the pledgor.

Cross References:
Sections 8-207; 8-321; 8-401.

Definitional Cross References:
"Secured Party". Section 9-105.
"Security". Section 8-102.
"Security Interest". Section 1-201.
"Uncertificated Security". Section 8-102.

Editor's Note. — Session Laws 1989, c. 588, s. 3 made this section effective October 1, 1989.

PART 2.

ISSUE—ISSUER.

§ 25-8-201. "Issuer."

(1) With respect to obligations on or defenses to a security "issuer" includes a person who

(a) Places or authorizes the placing of his name on a certificated security (otherwise than as authenticating trustee, registrar, transfer agent or the like) to evidence that it represents a share, participation or other interest in his property or in an enterprise or to evidence his duty to perform an obligation represented by the certificated security;

(a1) Creates shares, participations, or other interests in his property or in an enterprise or undertakes obligations, which shares, participations, interests or obligations are certificated securities;

(b) Directly or indirectly creates fractional interests in his rights or property which fractional interests are represented by certificated securities; or

(c) Becomes responsible for or in place of any other person described as an issuer in this section.

(2) With respect to obligations on or defenses to a security, a guarantor is an issuer to the extent of his guaranty whether or not his obligation is noted on a certificated security or on statements of uncertificated securities sent pursuant to G.S. 25-8-402.

(3) With respect to registration of transfer, pledge, or release (Part 4 of this Article) "issuer" means a person on whose behalf transfer books are maintained. (1899, c. 733, ss. 29, 60 to 62; Rev.,

ss. 2177, 2209 to 2211; C.S., ss. 3009, 3041 to 3043; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1989 (Reg. Sess., 1990), c. 1024, s. 9(b).)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 29, 60, 61 and 62, Uniform Negotiable Instruments Law.

Purposes:

1. Part 2 of Article 8 describes the rights and duties of an "issuer" of a security. It is generally understood that an "issuer" is the one who creates the property interest that is a "security" and who thereby incurs obligations to purchasers of that interest. This section provides the criteria for determining whether a person has incurred the obligations — and gained the rights — given to an issuer in this Article. Numerous rights and obligations arise from sources other than Article 8. This section does not determine whether a person is an "issuer" for purposes of those sources of law.

2. Paragraph (1)(a) makes a person an "issuer" for purposes of this Article if he authorizes the placing of his name on a certificate intending that it should be a certificated security (Section 8-102(1)(a)). This paragraph bears a close relationship to Section 8-102(1)(a), which describes the property interests that may constitute a "certificated security." The latter section describes those interests in terms of rights against "the issuer," while this section defines issuer in terms of authorizing the placing of a name on a "certificated security." The effect is to add to the definition of "certificated security" the requirement that it bear the authorized name of the person creating the property interests. Thus, if a certificate bears the *unauthorized* name of the purported issuer, the purported issuer is not an "issuer" within this Article; and the certificate is not a "certificated security." See Section 8-202(3) and its Comment 4. Section 8-205 describes the circumstances in which the purported issuer will be treated as if he were a true "issuer" despite the absence of his authorized signature.

3. Read in conjunction with the definition of "uncertificated security" in Section 8-102(1)(b), paragraph (1)(b) makes a person an "issuer" if he creates, and maintains books for the registration of ownership of, property interests that fit within the definition of an uncertificated security.

4. Subsection (2) distinguishes the obligations of a guarantor as issuer from those of the principal obligor. However, it does not exempt the guarantor from the impact of subsection (4) of Section 8-202. Whether or not the obligation of the guarantor is noted on the security or initial transaction statement (Section 8-408(4)) is immaterial. Typically, guarantors are parent corporations, or stand in some similar relationship to the principal obligor. If that relationship existed at the time the security originally was issued, the guaranty probably would be noted on the security or initial transaction statement. However, if the relationship arose afterward — e. g., through a purchase of stock or properties, or through merger or consolidation — probably the notation would not be made. Nonetheless, the owner of the security is entitled to the benefit of the obligation of the guarantor.

5. Subsection (3) narrows the definition of "issuer" for purposes of Part 4 of this Article (registration of transfer). It is supplemented by Section 8-406.

Cross References:

Points 1, 2, and 3: Sections 8-102, 8-202 and 8-205.

Point 4: Section 8-202.

Point 5: Part 4 of this Article.

Definitional Cross References:

"Certificated Security". Section 8-102.

"Person". Section 1-201.

"Rights". Section 1-201.

"Security". Section 8-102.

"Uncertificated Security". Section 8-102.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, in subsection (1), subdivision (a), inserted "certificated," in two places, substituted "represented" for "evidenced," and deleted "or" at the end of the subdivision, added subdivision (a1), and substituted "represented by certificated securities" for "evidenced by securities" in subdivision (b); substituted "a certificated security or on statements of uncertificated securities sent pursuant to G.S. 25-8-402" for "the security" in subsection (2); and inserted "pledge, or release" in subsection (3).

The 1989 (Reg. Sess., 1990) amendment, effective July 27, 1990, substituted "Creates" for "Create" in subdivision (1)(a1).

§ 25-8-202. Issuer's responsibility and defenses; notice of defect or defense.

(1) Even against a purchaser for value and without notice the terms of a security include:

(a) If the security is certificated, those stated on the security;

(b) If the security is uncertificated, those contained in the initial transaction statement sent to such purchaser or, if his interest is transferred to him other than by registration of transfer, pledge, or release, the initial transaction statement sent to the registered owner or registered pledgee; and

(c) Those made part of the security by reference, on the certificated security or in the initial transaction statement, to another instrument, indenture, or document or to a constitution, statute, ordinance, rule, regulation, order or the like, to the extent that the terms referred to do not conflict with the terms stated on the certificated security or contained in the statement. A reference under this paragraph does not of itself charge a purchaser for value with notice of a defect going to the validity of the security, even though the certificated security or statement expressly states that a person accepting it admits notice.

(2) A certificated security in the hands of a purchaser for value or an uncertificated security as to which an initial transaction statement has been sent to a purchaser for value, other than a security issued by a government or governmental agency or unit, even though issued with a defect going to its validity, is valid with respect to the purchaser if he is without notice of the particular defect unless the defect involves a violation of constitutional provisions, in which case the security is valid with respect to a subsequent purchaser for value and without notice of the defect. This subsection applies to an issuer that is a government or governmental agency or unit only if either there has been substantial compliance with the legal requirements governing the issue or the issuer has received a substantial consideration for the issue as a whole or for the particular security and a stated purpose of the issue is one for which the issuer has power to borrow money or issue the security.

(3) Except as provided in the case of certain unauthorized signatures (G.S. 25-8-205) lack of genuineness of a certificated security or an initial transaction statement is a complete defense, even against a purchaser for value and without notice.

(4) All other defenses of the issuer of a certificated or uncertificated security, including nondelivery and conditional delivery of a certificated security, are ineffective against a purchaser for value who has taken without notice of the particular defense.

(5) Nothing in this section shall be construed to affect the right of a party to a "when, as and if issued" or a "when distributed" contract to cancel the contract in the event of a material change in the character of the security that is the subject of the contract or in the

plan or arrangement pursuant to which the security is to be issued or distributed. (1899, c. 733, ss. 23, 28, 56, 57, 61, 62; Rev., ss. 2171, 2176, 2205, 2206, 2210, 2211; C.S., ss. 3003, 3008, 3037, 3038, 3042, 3043; 1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provisions: Sections 16, 23, 28, 56, 57, 60, 61, 62, Uniform Negotiable Instruments Law.

Purposes:

1. A purchaser must have some method of learning the terms of the security he is purchasing. The printing on the certificate or on the initial transaction statement ("ITS") is designed to notify the purchaser of those terms. If he purchases without examining the certificate or ITS, he does so at his peril, since he is charged with notice of terms stated thereon.

Some methods of transferring a security do not involve the actual delivery of a certificate or the sending of an ITS to the actual purchaser. See Section 8-313(1)(c)-(j). The situations in which these methods of transfer will be used can be divided into two categories — those in which an intermediary takes a transfer for his principal and those in which a bailee "holding" a security effects a transfer by receiving notice of, or sending acknowledgement of, the purchase. In either type of situation the purchaser will be charged with notice of all terms stated on the certificate if the security is certificated or, if the security is uncertificated, with notice of all terms stated in the ITS sent to the registered owner or registered pledgee. For example, suppose that Customer purchases an uncertificated security that is already registered in the name of his broker. Customer is content to allow the security to remain registered in Broker's name, so that Customer never receives an ITS. Customer is charged with notice of the terms stated on the ITS sent to Broker when Broker became the registered owner. Or suppose that Purchaser buys a certificated security and the transfer is effected not by delivering the certificate but by having Bailee, who holds the security, acknowledge that he holds for Purchaser. Purchaser is charged with notice of the terms written on the certificate.

It is apparent that in these situations a purchaser must rely upon the intermediary or bailee who "holds" the security for him.

2. Subsection (1)(c) states, in accordance with the prevailing case law, the right of the issuer (who prepares the text of the security or statement) to include terms incorporated by adequate reference to an extrinsic source, so long as the terms so incorporated do not conflict with the stated terms. Thus the standard practice of referring in a bond or debenture to the trust indenture under which it is issued without spelling out its necessarily complex and lengthy provisions is approved. Every stock certificate or ITS will refer in some manner to the charter or articles of incorporation of the issuer. At least where there is more than one class of stock authorized, applicable corporation codes specifically require a statement or summary as to preferences, voting powers and the like. References to constitutions, statutes, ordinances, rules, regulations or orders are not so common except in the obligations of governments or governmental agencies or units; but where appropriate they fit into the rule here stated.

Following the basic principles of the Negotiable Instruments Law the cases have generally held that an issuer is estopped from denying representations made in the text of a security. Delaware-New Jersey Ferry Co. v. Leeds, 21 Del.Ch. 279, 186 A. 913 (1936). Nor is a defect in form or the invalidity of a security normally available to the issuer as a defense. Bonini v. Family Theatre Corporation, 327 Pa. 273, 194 A. 498 (1937); First National Bank of Fairbanks v. Alaska Airmotive, 119 F.2d 267 (C.C.A.Alaska 1941).

This general rule of estoppel is here adopted in favor of purchasers, with the exception noted above.

3. The last sentence of subsection (1) and all of subsection (2) embody the concept that it is the duty of the issuer, not of the purchaser, to make sure that the security complies with the law governing its issue. The last sentence of subsection (1) makes clear that the issuer cannot, by incorporating a reference to a statute or other document, charge the purchaser with notice of the security's invalidity. Subsection (2) gives to a pur-

chaser for value without notice of the defect the right to enforce the security against the issuer despite the presence of a defect that otherwise would render the security invalid. This right accrues to a purchaser regardless of whether the security has been transferred to him through physical delivery of a certificate (Section 8-313(1)(a)), through registration of transfer or pledge of an uncertificated security (Section 8-313(1)(b)), or through some other method in which he receives no certificate or initial transaction statement. (Section 8-313(1)(c)-(j)). There are three circumstances in which a purchaser does not gain such rights: first, if the defect involves a violation of constitutional provisions, these rights accrue only to a subsequent purchaser (Section 8-102(2)). This Article leaves to the law of each particular state the rights of a purchaser on original issue of a security with a constitutional defect. No negative implication is intended by the explicit grant of rights to a subsequent purchaser.

Second, governmental issuers are distinguished in subsection (2) from other issuers as a matter of public policy, and additional safeguards are imposed before governmental issues are validated. Governmental issuers are estopped from asserting defenses only if there has been substantial compliance with the legal requirements governing the issue or if substantial consideration has been received and a stated purpose of the issue is one for which the issuer has power to borrow money or issue the security. The purpose of the substantial compliance requirement is to make certain that a mere technicality as, e.g., in the manner of publishing election notices, shall not be a ground for depriving an innocent purchaser of his rights in the security. The policy is here adopted of such cases as Tommie v. City of Gadsden, 229 Ala. 521, 158 So. 763 (1935), in which minor discrepancies in the form of the election ballot used were overlooked and the bonds were declared valid since there had been substantial compliance with the statute.

A long and well established line of Federal cases recognizes the principle of estoppel in favor of bona fide purchasers where municipalities issue bonds containing recitals of compliance with governing constitutional and statutory provisions, made by the municipal authorities entrusted with determining such compliance. Chaffee County v. Potter, 142 U.S. 355, 12 S.Ct. 216, 35 L.Ed. 1040 (1892); Oregon v. Jennings, 119 U.S. 74, 7 S.Ct. 124, 30 L.Ed. 323 (1886); Gunnison County Commissioners v. Rollins, 173 U.S. 255, 19 S.Ct. 390, 43 L.Ed. 689 (1898). This rule has been qualified, however, by requiring that the municipality have power to issue the security. Anthony v. County of Jasper, 101 U.S. 693, 25 L.Ed. 1005 (1879); Town of South Ottawa v. Perkins, 94 U.S. 260, 24 L.Ed. 154 (1876). This section follows the case law trend, simplifying the rule by setting up two conditions for an estoppel against a governmental issuer: (1) substantial consideration given, and (2) power in the issuer to borrow money or issue the security for the stated purpose. As a practical matter the problem of policing governmental issuers has been alleviated by the present practice of requiring legal opinions as to the validity of the issue. The bulk of the case law on this point is more than 50 years old and it may be assumed that the question now seldom arises.

Section 8-104, regarding overissue, provides the third exception to the rule that an innocent purchase[r] for value takes a valid security despite the presence of a defect that would otherwise give rise to invalidity. See that section and its comment for further explanation.

4. Subsection (3) is in effect a definitional provision. The person purported to have issued a certificated security is not an "issuer", and the certificate is not a "certificated security", unless that person actually took the actions that constitute issue. See Sections 8-102(1)(a) and 8-201(1). Similarly, a statement purportedly sent by an issuer is not an "initial transaction statement" if it was not actually sent by the issuer (Section 8-408(4), (1), (2) and (3)). Section 8-205 is a caveat to both of these general rules.

5. Subsection (4) gives the general rule that defenses of the issuer are ineffective against a purchaser for value without notice of the defense. Notice to the purchaser may come from sources other than a notation on a certificate or an initial transaction statement. Compare Section 8-103 with respect to an issuer's lien.

6. Subsection (5) is included to make clear that this section does not affect the presently recognized right of either party to a "when, as and if" or "when distributed" contract to cancel the contract on substantial change.

Cross References:
Point 1: Section 8-313.
Point 2: Sections 1-201, 8-103, 8-203, 8-204.
Point 3: Sections 1-201, 8-102 and 8-104.
Point 4: Sections 8-102, 8-201 and 8-205.
Point 5: Section 8-103.
See Sections 8-104, 8-203, 8-205, and 8-206.

Definitional Cross References:
"Certificated Security". Section 8-102.
"Delivery". Section 1-201.
"Genuine". Section 1-201.
"Initial Transaction Statement". Section 8-408.
"Issuer". Section 8-201.
"Money". Section 1-201.
"Notice". Section 1-201.
"Person". Section 1-201.
"Purchaser". Section 1-201.
"Security". Section 8-102.
"Subsequent Purchaser". Section 8-102.
"Term". Section 1-201.
"Unauthorized Signature". Section 1-201.
"Uncertificated Security". Section 8-102.
"Value". Section 1-201.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, rewrote this section.

§ 25-8-203. Staleness as notice of defects or defenses.

(1) After an act or event which creates a right to immediate performance of the principal obligation represented by a certificated security or which sets a date on or after which the security is to be presented or surrendered for redemption or exchange, a purchaser is charged with notice of any defect in its issue or defense of the issuer if

(a) The act or event is one requiring the payment of money, the delivery of certificated securities, the registration of transfer of uncertificated securities, or any of these on presentation or surrender of the certificated security, the funds or securities are available on the date set for payment or exchange and he takes the security more than one year after that date; and

(b) The act or event is not covered by paragraph (a) and he takes the security more than two years after the date set for surrender or presentation or the date on which such performance became due.

(2) A call which has been revoked is not within subsection (1). (1899, c. 733, ss. 52, 53; Rev., ss. 2201, 2202; C.S., ss. 3033, 3034; 1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 52(2), 53, Uniform Negotiable Instruments Law.

Purposes:

1. The problem of matured or called securities is here dealt with in terms of the effect of such events in giving notice of the issuer's defenses and not in terms of "negotiability". The substance of this section applies only to certificated securities because such securities may be transferred to a purchaser by delivery after they have matured, been called or become redeemable or exchangeable. It is contemplated that uncertificated securities which have matured or been called will merely be cancelled on the books of the issuer and the proceeds sent to the registered owner or registered pledgee,

as the case may be. Uncertificated securities which have become redeemable or exchangeable, at the option of the owner, may be transferred to a purchaser, but the transfer is effectuated only by registration of transfer, thus necessitating communication with the issuer. If defects or defenses in such securities exist, the issuer will necessarily have the opportunity to bring them to the attention of the purchaser in the initial transaction statement sent to him.

2. The fact that a certificated security is in circulation long after it has been called for redemption or exchange must give rise to the question in a purchaser's mind as to why it has not been surrendered. After the lapse of a reasonable period of time he can no longer claim that he had "no reason to know" of any defects or irregularities in its issue. Where funds are available for the redemption of the security it is normally turned in more promptly and a shorter time is set as the "reasonable period", subsection (1)(a), than is set where funds are not available.

It is true that defaulted certificated securities are frequently traded on financial markets in the same manner as unmatured and undefaulted instruments and a purchaser might not be placed upon notice of irregularity by the mere fact of default. An issuer, however, should at some point be placed in a position to determine definitely its liability on an invalid or improper issue, and for this purpose a security under this section becomes "stale" two years after the default. But notice that a different rule applies when the question is notice not of issuer's defenses but of claims of ownership. Section 8-305 and comment.

3. Nothing in this section is designed to extend the life of preferred stocks called for redemption as "shares of stock" beyond the redemption date. After such a call, the security represents only a right to the funds set aside for redemption.

Cross References:
Sections 8-104, 8-202 and 8-305.

Definitional Cross References:
"Certificated Security". Section 8-102.
"Delivery". Section 1-201.
"Issuer". Section 8-201.
"Money". Section 1-201.
"Notice". Section 1-201.
"Purchaser". Section 1-201.
"Right". Section 1-201.
"Security". Section 8-102.
"Uncertificated Security". Section 8-102.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, in subsection (1), in the introductory language substituted "represented by a certificated security" for "evidenced by the security," and added "if" at the end of the language, in subdivision (a), deleted "if" at the beginning of the subdivision, substituted "money, the delivery of certificated securities, the registration of transfer of uncertificated securities, or any of these" for "money or the delivery of securities or both," inserted "certificated," and substituted "the funds" for "and such funds," and deleted "If" at the beginning of subdivision (b).

§ 25-8-204. Effect of issuer's restrictions on transfer.

A restriction on transfer of a security imposed by the issuer, even if otherwise lawful, is ineffective against any person without actual knowledge of it unless:

(a) The security is certificated and the restriction is noted conspicuously thereon; or

(b) The security is uncertificated and a notation of the restriction is contained in the initial transaction statement sent to the person or, if his interest is transferred to him other than by registration of transfer, pledge, or release, the initial transaction statement sent to the registered owner or the registered pledgee. (1941, c. 353, s. 15; G.S., s. 55-95; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 15, Uniform Stock Transfer Act.

Purposes:

1. Use of the words "noted" and "notation" is intended to make clear that the restriction need not be set forth in full text. See Allen v. Biltmore Tissue Corporation, 2 N.Y.2d 534, 141 N.E.2d 812 (1957).

2. Securities traded on financial markets are generally assumed to be free of adverse claims (Section 8-302). That assumption should not be lightly negated. Therefore, a strict rule as to notice of a restriction on transfer is here imposed. The issuer can protect itself by noting the restriction on the certificate or initial transaction statement. Refusal by an issuer to register a transfer on the basis of an unnoted restriction constitutes a conversion and the issuer can be compelled to register the transfer under the policy of Part 4 of this Article. Hulse v. Consolidated Quicksilver Mining Corporation, 65 Idaho 768, 154 P.2d 149 (1944); Mancini v. Patrizi, 110 Cal.App. 42, 293 P. 828 (1930). Conversely, the issuer to whom a certificated security with proper notation of a restriction is presented thereby receives timely notification of an adverse claim and is under a duty to inquire (Section 8-403).

A purchaser with actual knowledge of an unnoted restriction certainly has notice of an adverse claim (Section 8-304 and Comment). In that situation this section adopts the reasoning of Baumohl v. Goldstein, 95 N.J. Eq. 597, 124 A. 118 (1924), and Tomoser v. Kamphausen, 307 N.Y. 797, 121 N.E.2d 622 (1954), rejecting the contrary holding of such cases as Costello v. Farrell, 234 Minn. 453, 48 N.W.2d 557, 29 A.L.R.2d 890 (1951).

3. A transferee who purchases securities in organized financial markets often may neither take physical delivery of a certificated security nor have an uncertificated security registered in his name. See Section 8-313(1)(c) through (j). Under those circumstances the transferee may have no occasion to examine the writing on the certificate or the initial transaction statement. Nonetheless the transferee is charged with notice of restrictions noted on the certificate or on the initial transaction statement sent to the registered owner or registered pledgee. See Section 8-202(1) and Comment 1 thereto.

4. Most jurisdictions recognize the right of issuers to impose restrictions giving either the issuer itself or other stockholders the option to purchase the security at an ascertained price before it is offered to third parties. Vannucci v. Peduni, 217 Cal. 138, 17 P.2d 706 (1932); People ex rel. Rudaitis v. Galskis, 233 Ill. App. 414 (1924); Bloomingdale v. Bloomingdale, 107 Misc. 646, 177 N.Y.S. 873 (1919). This is the type of restriction contemplated by the present section. Mere notation on the certificate or initial transaction statement cannot, of course, validate an otherwise unlawful restriction. The present section in no way alters the prevailing case law which recognizes free alienability as an inherent attribute of securities and holds invalid unreasonable restraints on alienation such as those requiring consents of directors without establishing criteria for the granting or withholding of such consents and those giving the directors an option of purchase at a price to be fixed in their sole discretion. Howe v. Roberts, 209 Ala. 80, 95 So. 344 (1923); People ex rel. Malcom v. Lake Sand Corporation, 251 Ill.App. 499 (1929); Morris v. Hussong Dyeing Machine Co., 81 N.J.Eq. 256, 86 A. 1026 (1913); New England Trust Co. v. Abbott, 162 Mass. 148, 38 N.E. 432, 27 L.R.A. 271 (1894).

No interference is intended with the common practice of closing books for proper corporate purposes.

5. Cooperative associations and ventures, as well as private clubs are generally considered an exception to the rules against restrictions on transfer as unreasonable restraints on alienation and are permitted for example to require the consents of governing bodies such as a board of directors. Penthouse Properties, Inc. v. 1158 Fifth Avenue, Inc., 256 App.Div. 685, 11 N.Y.S.2d 417 (1939).

Historically restrictions on transfer were most commonly imposed by so-called "closely-held" issuers (including cooperatives and the like) in an attempt to restrict control if not total membership to a homogeneous security holder group. They have been increasingly resorted to by issuers with publicly held securities seeking to police enforcement of the registration requirements of the Securities Act of 1933 against persons purchasing their securities in a transaction exempt from those requirements (e.g., one "not involving any public offering" [Securities Act of 1933, Section 4(2)]) or against persons in a "control" relationship to the issuer. [See Securities Act of 1933, Section 2(11) and Rule 405 of the Rules and Regulations of the Securities and Exchange Commission under that Act.] Particularly in the latter context in which notation of the restriction on all affected certificates or initial transaction statements may not be practical, the issuer enforces it by notifying the holders of such certificates and refusing requests to register transfer out of the name of the "controlling person" either for purposes of sale or for delivery after sale, relying on the stated exception as to a person "with actual knowledge" of the restriction.

6. This section deals only with restrictions imposed by the issuer and restrictions imposed by statute are not affected. See Quiner v. Marblehead Social Co., 10 Mass. 476 (1813); Madison Bank v. Price, 79 Kan. 289, 100 P. 280 (1909); Healey v. Steele Center Creamery Ass'n, 115 Minn. 451, 133 N.W. 69 (1911). Nor does it deal with private agreements between stockholders containing restrictive covenants as to the sale of the security as in In re Consolidated Factors Corporation, 46 F.2d 561 (S.D.N.Y. 1931).

7. An analogous provision concerning issuer's liens appears at Section 8-103.

Cross References:

Point 7: Section 8-103.
See Part 4 of this Article.

Definitional Cross References:

"Certificated Security". Section 8-102.
"Conspicuous". Section 1-201.
"Initial Transaction Statement". Section 8-408.
"Issuer". Section 8-201.
"Knowledge". Section 1-201.
"Person". Section 1-201.
"Security". Section 8-102.
"Uncertificated Security". Section 8-102.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, substituted the present section for the former section which read: "Unless noted conspicuously on the security a restriction on transfer imposed by the issuer even though otherwise lawful is ineffective except against a person with actual knowledge of it."

§ 25-8-205. Effect of unauthorized signature on certificated security or initial transaction statement.

An unauthorized signature placed on a certificated security prior to or in the course of issue or placed on an initial transaction statement is ineffective, but the signature is effective in favor of a purchaser for value of the certificated security or a purchaser for value of an uncertificated security to whom the initial transaction statement has been sent, if the purchaser is without notice of the lack of authority and the signing has been done by:

(a) An authenticating trustee, registrar, transfer agent, or other person entrusted by the issuer with the signing of the security, of similar securities, or of initial transaction statements or the immediate preparation for signing of any of them; or

(b) An employee of the issuer, or of any of the foregoing, entrusted with responsible handling of the security or initial transaction statement. (1899, c. 733, s. 23; Rev., s. 2171; C.S., s. 3003; 1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 23, Uniform Negotiable Instruments Law.

Purposes:

1. In current practice the problem of forged or unauthorized signatures arises most frequently where an employee of the issuer, transfer agent or registrar has access to securities which he is required to prepare for issue by affixing the corporate seal or by adding a signature necessary for issue. This section is based upon the issuer's duty to avoid the negligent entrusting of securities to such persons. Issuers have long been held responsible for signatures placed upon securities by parties whom they have held out to the public as authorized to prepare such securities. See Fifth Avenue Bank of New York v. The Forty-Second Street & Grand Street Ferry Railroad Co., 137 N.Y. 231, 33 N.E. 378, 19 L.R.A. 331, 33 Am.St.Rep. 712 (1893); Jarvis v. Manhattan Beach Co., 148 N.Y. 652, 43 N.E. 68, 31 L.R.A. 776, 51 Am.St.Rep. 727 (1896). The "apparent authority" concept of some of the caselaw, however, is here extended and this section expressly rejects the technical distinction, made by courts reluctant to recognize forged signatures, between cases where the forger signs a signature he is authorized to sign under proper circumstances and those in which he signs a signature he is never authorized to sign. Citizens' & Southern National Bank v. Trust Co. of Georgia, 50 Ga.App. 681, 179 S.E. 278 (1935). Normally the purchaser is not in a position to determine which signature a forger, entrusted with the preparation of securities, has "apparent authority" to sign and which he has not. The issuer, on the other hand, can protect itself against such fraud by the careful selection and bonding of agents and employees, or by action over against transfer agents and registrars who in turn may bond their personnel.

2. It is contemplated that purchasers of uncertificated securities will rely on initial transaction statements (ITS's) sent to them, much as purchasers of certificated securities rely on certificates. The issuer's signature is thus required to ensure genuineness of the ITS. Section 8-408(4). In this regard the principal difference between certificates and ITS's is that only the one to whom the ITS is sent can safely rely on it, whereas a certificated security is a negotiable instrument and may be relied upon by transferees other than the original purchaser. The issuer's responsibility for unauthorized signatures otherwise is the same in both instances.

A transferee of an uncertificated security may be protected indirectly by this section despite the fact that he has not received the ITS. If his transferor received an ITS and was protected by this section, Section 8-301(1) gives those rights to the transferee.

3. The issuer cannot be held liable for the honesty of employees not entrusted, directly or indirectly, with the signing, preparation, or responsible handling of similar securities or similar ITS's and whose possible commission of forgery it has no reason to anticipate. The result in such cases as Hudson Trust Co. v. American Linseed Co., 232 N.Y. 350, 134 N.E. 178 (1922), and Dollar Savings Fund & Trust Co. v. Pittsburgh Plate Glass Co., 213 Pa. 307, 62 A. 916, 5 Ann.Cas. 248 (1906) is here adopted.

4. This section is not concerned with forged or unauthorized indorsements (Section 8-311), but only with unauthorized signatures of issuers, transfer agents, etc., placed upon certificated securities or initial transaction statements during the course of their issue. The protection here stated is available to all purchasers for value without notice and not merely to subsequent purchasers.

Cross References:

Point 4: Section 8-311.
See Section 8-202(3).

Definitional Cross References:

"Certificated Security". Section 8-102.
"Initial Transaction Statement". Section 8-408.
"Issuer". Section 8-201.
"Notice". Section 1-201.
"Person". Section 1-201.
"Purchaser". Section 1-201.
"Security". Section 8-102.
"Sign". Section 1-201.
"Unauthorized Signature". Section 1-201.
"Uncertificated Security". Section 8-102.
"Value". Section 1-201.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, substituted the present catchline for "Effect of unauthorized signature on issue," and rewrote this section.

§ 25-8-206. Completion or alteration of certificated security or initial transaction statement.

(1) If a certificated security contains the signatures necessary to its issue or transfer but is incomplete in any other respect:

(a) Any person may complete it by filling in the blanks as authorized; and

(b) Even though the blanks are incorrectly filled in, the security as completed is enforceable by a purchaser who took it for value and without notice of the incorrectness.

(2) A complete certificated security that has been improperly altered, even though fraudulently, remains enforceable; but only according to its original terms.

(3) If an initial transaction statement contains the signatures necessary to its validity, but is incomplete in any other respect:

(a) Any person may complete it by filling in the blanks as authorized; and

(b) Even though the blanks are incorrectly filled in, the statement as completed is effective in favor of the person to whom it is sent if he purchased the security referred to therein for value and without notice of the incorrectness.

(4) A complete initial transaction statement that has been improperly altered, even though fraudulently, is effective in favor of a purchaser to whom it has been sent, but only according to its original terms. (1899, c. 733, ss. 14, 15, 124; Rev., ss. 2164, 2165, 2274; C.S., ss. 2995, 2996, 3106; 1941, c. 353, s. 16; G.S., s. 55-96; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 14, 15 and 124, Uniform Negotiable Instruments Law; Section 16, Uniform Stock Transfer Act.

Purposes:

1. The problem of forged or unauthorized signatures necessary for the issue or transfer of a security or for the authentication of an initial transaction statement is not involved here, and a person in possession of a blank certificate or of a writing that would be an initial transaction statement if it were properly signed is not, by this section, given authority to fill in blanks with such signatures.

2. Completion of blanks left in a transfer instruction is dealt with elsewhere (Section 8-308 (5)). Blanks left upon authentication of an initial transaction statement or upon issue of a certificated security are the only ones dealt with here, and a purchaser for value without notice is protected. A purchaser is not in a good position to determine whether blanks were completed by the issuer or by some person not authorized to complete them. On the other hand the issuer can protect itself by not placing its signature on the writing until the blanks are completed or, if it does sign before all blanks are completed, by carefully selecting the agents and employees to whom it entrusts the writing after authentication. With respect to a certificated security or an initial transaction statement that is completed by the issuer but later is altered, the issuer has done everything it can to protect the purchaser and thus is not charged with the terms as altered. However, it is

charged according to the original terms, since it is not thereby prejudiced.

If the completion or alteration is obviously irregular, the purchaser may be charged with notice. See Section 1-201(25).

3. Only the purchaser who physically takes the certificate or receives the initial transaction statement is directly protected. However, a transferee may receive protection indirectly through Section 8-301(1).

4. The protection granted a purchaser for value without notice under this section is modified to the extent that an overissue may result where an incorrect amount is inserted into a blank (Section 8-104).

Cross References:

Point 2: Sections 1-201, 8-302 and 8-308. Point 3: Section 8-301. Point 4: Section 8-104. See Sections 8-205 and 8-311.

Definitional Cross References:

"Certificated Security". Section 8-102.

"Initial Transaction Statement". Section 8-408.

"Notice". Section 1-201.

"Person". Section 1-201.

"Purchaser". Section 1-201.

"Security". Section 8-102.

"Term". Section 1-201.

"Uncertificated Security". Section 8-102.

"Value". Section 1-201.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, substituted the present catchline for "Completion or alteration of instrument," and rewrote this section.

§ 25-8-207. Rights and duties of issuer with respect to registered owners and registered pledgees.

(1) Prior to due presentment for registration of transfer of a certificated security in registered form, the issuer or indenture trustee may treat the registered owner as the person exclusively entitled to vote, to receive notifications, and otherwise to exercise all the rights and powers of an owner.

(2) Subject to the provisions of subsections (3), (4), and (6) of this section, the issuer or indenture trustee may treat the registered owner of an uncertificated security as the person exclusively entitled to vote, to receive notifications, and otherwise to exercise all the rights and powers of an owner.

(3) The registered owner of an uncertificated security that is subject to a registered pledge is not entitled to registration of transfer prior to the due presentment to the issuer of a release instruction. The exercise of conversion rights with respect to a convertible uncertificated security is a transfer within the meaning of this section.

(4) Upon due presentment of a transfer instruction from the registered pledgee of an uncertificated security, the issuer shall:

(a) Register the transfer of the security to the new owner free of pledge, if the instruction specifies a new owner (who may be the registered pledgee) and does not specify a pledgee;

(b) Register the transfer of the security to the new owner subject to the interest of the existing pledgee, if the instruction specifies a new owner and the existing pledgee; or

(c) Register the release of the security from the existing pledge and register the pledge of the security to the other pledgee, if the instruction specifies the existing owner and another pledgee.

(5) Continuity of perfection of a security interest is not broken by registration of transfer under subsection (4)(b) or by registration of release and pledge under subsection (4)(c), if the security interest is assigned.

(6) If an uncertificated security is subject to a registered pledge:

(a) Any uncertificated securities issued in exchange for or distributed with respect to the pledged security shall be registered subject to the pledge;

(b) Any certificated securities issued in exchange for or distributed with respect to the pledged security shall be delivered to the registered pledgee; and

(c) Any money paid in exchange for or in redemption of part or all of the security shall be paid to the registered pledgee.

(7) Nothing in this Article shall be construed to affect the liability of the registered owner of a security for calls, assessments, or the like. (1941, c. 353, s. 3; G.S., s. 55-83; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 3, Uniform Stock Transfer Act.

Purposes:

1. Subsection (1) states the issuer's right to treat the registered owner of a certificated security as the person entitled to exercise all the rights of an owner. This right of the issuer is limited by the provisions of Part 4 of this article — once there has been due presentation for registration of transfer, the issuer has a duty to register ownership in the name of the transferee. Section 8-401. Thus its right to treat the old registered owner as exclusively entitled to the rights of ownership must cease.

Subsection (2) states a parallel rule for uncertificated securities, with the important exception that the rights of the registered owner are curtailed when the uncertificated security is subject to a registered pledge. See Section 8-108. Thus, subsection (3) denies the registered owner the power to order transfer of an uncertificated security subject to a registered pledge until the pledge has been released by order of the pledgee. See Section 8-308(4) and (7) (b).

Subsection (4) establishes the right of the registered pledgee to control the transfer of an uncertificated security subject to his pledge. The three paragraphs of subsection (4) illustrate the mechanics for three common transactions: (a) the outright transfer of the security, free of the pledge; (b) the transfer of registered ownership, subject to the pledge; and (c) the transfer of the pledgee's interest without disturbing the registered ownership. These transactions are not intended to be exclusive. For example, the transfer of a pledged uncertificated security to a new owner subject to the interest of a new pledgee might be accomplished in several ways. There could be a release of his interest by the old pledgee followed by a transfer of registered ownership from the old owner to the new owner and a pledge from the new owner to the new pledgee. Or, if the respective pledgees wished to maintain complete control over the security, the old pledgee could order a transfer of his interest to the new pledgee under paragraph (c) and the new pledgee could then order the transfer of registered ownership from the old owner to the new owner under paragraph (b). Still other combinations are possible, depending on the positions of the parties.

Subsection (6) insures that stock dividends or splits issued with respect to a pledged uncertificated security and securities or money distributed or paid in exchange for a pledged uncertificated security will remain within the control of the registered pledgee. This result cannot be extended to pledges of certificated securities because the issuer will normally be unaware of the pledgee's rights unless the pledgee has caused a transfer to be registered.

2. The rule of such cases as Turnbull v. Longacre Bank, 249 N.Y. 159, 163 N.E. 135 (1928), which held the issuer

liable for paying out dividends to the record holder after the transferee had given notice of the transfer and demanded that a new certificate be issued to him, is left unchanged. However, such cases as Morrison v. Gulf Oil Corporation, 189 Miss. 212, 196 So. 247 (1940), holding that Section 3 of the Uniform Stock Transfer Act did not change the common law as to the issuer's liability for dealing with the record holder after mere notice of a pledge, are expressly rejected. Mere notice is not enough under this section to impose upon the issuer the duty of dealing with the pledgee although it may constitute notice to the issuer of a claim of ownership under Part 4.

Subsections (1) and (2) are permissive and do not require that the issuer deal exclusively with the registered owner. It is free to require proof of ownership before paying out dividends or the like if it chooses to. Barbato v. Breeze Corporation, 128 N.J.L. 309, 26 A.2d 53 (1942).

3. This section does not operate to determine who is finally entitled to exercise voting and other rights or to receive payments and distributions. The parties are still free to incorporate their own arrangements as to these matters in seller-purchaser agreements which will be definitive as between them.

4. No change in existing state laws as to the liability of registered owners for calls and assessments is here intended; nor is anything in this section designed to estop a record holder from denying ownership when assessments are levied if he is otherwise entitled to do so under state law. See State ex rel. Squire v. Murfey, Blosson & Co., 131 Ohio St. 289, 2 N.E.2d 866 (1936); Willing v. Delaplaine, 23 F.Supp. 579 (1937).

5. No interference is intended with the common practice of closing the transfer books or taking a record date for dividend, voting and other purposes, as provided for in by-laws, charters and statutes.

Cross References:

Section 8-108 and Part 4 of this Article.

Definitional Cross References:

"Certificated Security". Section 8-102.
"Instruction". Section 8-308.
"Issuer". Section 8-201.
"Money". Section 1-201.
"Notification". Section 1-201.
"Person". Section 1-201.
"Registered Form". Section 8-102.
"Right". Section 1-201.
"Security". Section 8-102.
"Security Interest". Section 9-105.
"Uncertificated Security". Section 8-102.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, substituted the present catchline for "Rights of issuer with respect to registered owners," and rewrote this section.

§ 25-8-208. Effect of signature of authenticating trustee, registrar or transfer agent.

(1) A person placing his signature upon a certificated security or an initial transaction statement as authenticating trustee, registrar, transfer agent, or the like, warrants to a purchaser for value of the certificated security or a purchaser for value of an uncertificated security to whom the initial transaction statement has been sent, if the purchaser is without notice of the particular defect, that:

(a) The certificated security or initial transaction statement is genuine;

(b) His own participation in the issue or registration of the transfer, pledge, or release of the security is within his capacity and within the scope of the authority received by him from the issuer; and

(c) He has reasonable grounds to believe that the security is in the form and within the amount the issuer is authorized to issue.

(2) Unless otherwise agreed, a person by so placing his signature does not assume responsibility for the validity of the security in other respects. (1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. The warranties here stated express the current understanding and prevailing case law as to the effect of the signatures of authenticating trustees, transfer agents, and registrars. See Jarvis v. Manhattan Beach Co., 148 N.Y. 652, 43 N.E. 68, 31 L.R.A. 776, 51 Am.St.Rep. 727 (1896). Although it has generally been regarded as the particular obligation of the transfer agent to determine whether securities are in proper form as provided by the by-laws and Articles of Incorporation, neither a registrar nor an authenticating trustee should properly place a signature upon a certificate or transaction statement without determining whether it is at least regular on its face. The obligations of these parties in this respect have therefore been made explicit in terms of due care. See Feldmeier v. Mortgage Securities, Inc., 34 Cal.App.2d 201, 93 P.2d 593 (1939).

2. Those cases which hold that an authenticating trustee is not liable for any defect in the mortgage or property which secures the bond or for any fraudulent misrepresentations made by the issuer are not here affected since these matters do not involve the genuineness or proper form of the security. Ainsa v. Mercantile Trust Co., 174 Cal. 504, 163 P. 898 (1917); Tschetinian v. City Trust Co., 186 N.Y. 432, 79 N.E. 401 (1906); Davidge v. Guardian Trust Co. of New York, 203 N.Y. 331, 96 N.E. 751 (1911).

3. The charter or an applicable statute may affect the capacity of a bank or other corporation undertaking to act as an authenticating trustee, registrar or transfer agent. See, for example, the Federal Reserve Act (U.S.C.A., Title 12, Banks and Banking, Section 248) under which the Board of Governors of the Federal Reserve Bank is authorized to grant special permits to National Banks permitting them to act as trustees. Such corporations are therefore held to certify as to their legal capacity to act as well as to their authority.

4. Authenticating trustees, registrars and transfer agents have normally been held liable for an issue in excess of the authorized amount. Jarvis v. Manhattan Beach Co., supra; Mullen v. Eastern Trust & Banking Co., 108 Me. 498, 81 A. 948 (1911). In imposing upon these parties a duty of due care with respect to the amount they are authorized to help issue, this section does not necessarily validate the security, but merely holds persons responsible for the excess issue liable in damages for any loss suffered by the purchaser.

5. Aside from questions of genuineness and excess issue these parties are not held to certify as to the validity of the security unless they specifically undertake to do so. The case law which has recognized a unique responsibility on the transfer agent's part to testify as to the validity of any security which it countersigns is rejected.

6. This provision does not prevent a transfer agent or issuer from agreeing with a registrar of stock to protect the registrar in respect of the genuineness and proper form of a certificated security or initial transaction statement signed by the issuer or the transfer agent or both. Nor does it interfere with proper indemnity arrangements between the issuer and trustees, transfer agents, registrars and the like.

7. An unauthorized signature is a signature for purposes of this section if and only if it is made effective by Section 8-205.

Cross References:

Sections 8-102, 8-205 and 8-406.

Definitional Cross References:

"Agreed". Section 1-201.
"Certificated Security". Section 8-102.
"Genuine". Section 1-201.
"Initial Transaction Statement". Section 8-408.
"Issuer". Section 8-201.
"Notice". Section 1-201.
"Person". Section 1-201.
"Purchaser". Section 1-201.
"Security". Section 8-102.
"Uncertificated Security". Section 8-102.
"Value". Section 1-201.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, rewrote this section.

PART 3.

TRANSFER.

§ 25-8-301. Rights acquired by purchaser.

(1) Upon transfer of a security to a purchaser (G.S. 25-8-313), the purchaser acquires the rights in the security which his transferor had or had actual authority to convey unless the purchaser's rights are limited by G.S. 25-8-302(4).

(2) A transferee of a limited interest acquires rights only to the extent of the interest transferred. The creation or release of a security interest in a security is the transfer of a limited interest in that security. (1899, c. 733, ss. 52, 57 to 59; Rev., ss. 2201, 2206 to 2208; C.S., ss. 3033, 3038 to 3040; 1941, c. 353, ss. 6, 7; G.S., ss. 55-86, 55-87; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 58, Uniform Negotiable Instruments Law.

Purposes:

1. The concept of transfer is defined only by example (Section 8-313), but it clearly involves the passing of rights in the security from one party to another. Subsection (1) states the "shelter" provision of the Negotiable Instruments Law — upon transfer of the security a purchaser acquires the rights his transferor had. There are at least three exceptions to this basic rule, two of which limit the purchaser's rights and one of which expands them. First, subsection (1) explicitly makes its rule subject to Section 8-302(4), which prevents certain transferees from being freed of the taint of earlier fraud or notice. The second exception, stated in subsection (2), is that there may be a transfer explicitly limited to an interest less than the transferor's entire interest. Finally Section 8-302 provides that a bona fide purchaser takes certain rights of his own account, regardless of the rights his transferor had.

2. Transfers by operation of law are not intended to be covered by this Article. For example, transfers from decedent to administrator, from ward to guardian, and from bankrupt to trustee in bankruptcy are governed by other law as to both the time they occur and the substance of the transfer. Subsequent delivery and registration on the issuer's records merely confirm what has already happened.

Cross References:
Sections 3-201 and 8-321.

Definitional Cross References:
"Purchaser". Section 1-201.
"Rights". Section 1-201.
"Security". Section 8-102.
"Security Interest". Section 1-201.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, deleted "'adverse claim'; title acquired by bona fide purchaser" from the end of the catchline, and rewrote this section.

§ 25-8-302. "Bona fide purchaser"; "adverse claim" title acquired by bona fide purchaser.

(1) A "bona fide purchaser" is a purchaser for value in good faith and without notice of any adverse claim:

(a) Who takes delivery of a certificated security in bearer form or in registered form, issued or indorsed to him or in blank;

(b) To whom the transfer, pledge, or release of an uncertificated security is registered on the books of the issuer; or

(c) To whom a security is transferred under the provisions of paragraph (c), (d)(i), or (g) of G.S. 25-8-313(1).

(2) "Adverse claim" includes a claim that a transfer was or would be wrongful or that a particular adverse person is the owner of or has an interest in the security.

(3) A bona fide purchaser in addition to acquiring the rights of a purchaser (G.S. 25-8-301), also acquires his interest in the security free of any adverse claim.

(4) Notwithstanding G.S. 25-8-301 the transferee of a particular certificated security who has been a party to any fraud or illegality affecting the security, or who as a prior holder of that certificated security had notice of an adverse claim, cannot improve his position by taking from a bona fide purchaser. (1899, c. 733, s. 52; Rev., s. 2201; C.S., s. 3033; 1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 52, 57, 58 and 59, Uniform Negotiable Instruments Law; Section 7, Uniform Stock Transfer Act.

Purposes:

1. Any purchaser for value of a security without notice of a particular defect may take free of the issuer's defense based on that defect, but only a purchaser taking by a formally perfect transfer, for value and without notice of any adverse claim, may take free of adverse claims. The "bona fide purchaser" here dealt with is the person taking free of adverse claims. His rights against the issuer are determined by Part 2 of this Article and his rights to registration are determined by Part 4.

2. Not every form of transfer can confer upon the purchaser the status of bona fide purchaser. In particular, transfers effected through the acknowledgement of a bailee who is not a financial intermediary or through the acknowledgement of a financial intermediary who holds for the transferee a proportionate interest in a fungible bulk do not confer bona fide purchaser status. However, the transferee can acquire all the rights of a bona fide purchaser through the "shelter" provisions of Section 8-301(1) if the transferor had those rights.

3. Protection is extended to bona fide purchasers of all investment securities, whether such securities were considered negotiable or non-negotiable under the prior law. This is the result sought by many cases which have resolved doubts in favor of negotiability despite terms in bonds which militated against their negotiability under the provisions of the Negotiable Instruments Law. See Paxton v. Miller, 102 Ind. App. 511, 200 N.E. 87 (1936); Scott v. Platt, 171 Or. 379, 135 P.2d 769 (1943). Such cases as U. S. Gypsum v. Faroll, 296 Ill. App. 47, 15 N.E.2d 888 (1938), protecting bona fide purchasers of stock certificates under the provisions of the Stock Transfer Act are adopted and approved.

4. An adverse claim may be either legal or equitable, e.g., that the claimant is the beneficial owner of a security, though not the legal owner of it, or that it has been or is proposed to be transferred in breach of trust or a valid restriction on transfer (See Section 8-204 and Comment). Note that there may be claims of ownership that are not "adverse" — e.g., the claim of a principal against his agent including that of a customer against his broker (Section 8-303). The agent's knowledge of his principal's

claim thus cannot defeat the agent's right to be a bona fide purchaser under this section.

5. Subsection (4) provides an exception to the "shelter" provisions of Section 8-301(1), but applies only to a transferee of a certificated security who as a prior holder of the particular security had notice of adverse claims or who has been a party to fraud or illegality affecting the particular security.

Cross References:
Sections 3-302 and 8-301. Point 4: Section 8-204 and its comment.

Definitional Cross References:
"Bearer Form". Section 8-102.
"Certificated Security". Section 8-102.
"Delivery". Section 1-201.
"Good Faith". Section 1-201.
"Holder". Section 1-201.
"Indorsed". Section 8-308.
"Notice". Section 1-201.
"Person". Section 1-201.
"Purchaser". Section 1-201.
"Registered Form". Section 8-102.
"Security". Section 8-102.
"Uncertificated Security". Section 8-102.
"Value". Section 1-201.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, substituted the present catchline for "Bona fide purchaser," and rewrote this section.

§ 25-8-303. "Broker".

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision:
None.

Purposes:
This section defines "broker" for purposes of this Article in terms of function in the particular transaction. The term is applicable to the person performing the function. The differentiation under the Securities Exchange Act of 1934 between "broker" and "dealer" is of no significance under this Article. This and similar distinctions are preserved for other purposes by the last sentence of the section.

Definitional Cross References:
"Person". Section 1-201.
"Security". Section 8-102.

§ 25-8-304. Notice to purchaser of adverse claims.

(1) A purchaser (including a broker for the seller or buyer but excluding an intermediary bank) of a certificated security is charged with notice of adverse claims if

(a) The security whether in bearer or registered form has been indorsed "for collection" or "for surrender" or for some other purpose not involving transfer; or

(b) The security is in bearer form and has on it an unambiguous statement that it is the property of a person other than the transferor. The mere writing of a name on a security is not such a statement.

(2) A purchaser (including a broker for the seller or buyer, but excluding an intermediary bank) to whom the transfer, pledge, or release of an uncertificated security is registered is charged with notice of adverse claims as to which the issuer has a duty under G.S. 25-8-403(4) at the time of registration and which are noted in the initial transaction statement sent to the purchaser or, if his interest is transferred to him other than by registration of transfer, pledge, or release, the initial transaction statement sent to the registered owner or the registered pledgee.

(3) The fact that the purchaser (including a broker for the seller or buyer) of a certificated or uncertificated security has notice that the security is held for a third person or is registered in the name of or indorsed by a fiduciary does not create a duty of inquiry into the rightfulness of the transfer or constitute constructive notice of adverse claims. However, if the purchaser (excluding an intermediary bank) has knowledge that the proceeds are being used or that the transaction is for the individual benefit of the fiduciary or otherwise in breach of duty, the purchaser is charged with notice of adverse claims. (1899, c. 733, ss. 37, 56; Rev., ss. 2186, 2205; C.S., ss. 3018, 3037; 1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 37, 56, Uniform Negotiable Instruments Law.

Purposes:

1. Section 8-302 defines "bona fide purchaser" in terms of three distinct elements, "value", "good faith", and lack of "notice of any adverse claim". This section deals only with notice and presents specific situations in which a purchaser is charged with notice of adverse claims as a matter of law. The listing is not exhaustive and does not exclude other situations in which the trier of the facts may determine that similar notice has been given. For example, receipt of notification that the particular security has been lost or stolen raises the question of notice "forgotten" in good faith. Kentucky Rock Asphalt v. Mazza's Admr., 264 Ky. 158, 94 S.W.2d 316 (1936); Graham v. White-Phillips Co., 296 U.S. 27, 56 S.Ct. 21, 80 L.Ed. 20, 102 A.L.R. 24 (1935) but cf., First National Bank of Odessa v. Fazzari, 10 N.Y.2d 394, 179 N.E.2d 493 (1961). Also suspicious characteristics of the transaction may give a purchaser (particularly a commercially sophisticated purchaser such as a broker) "reason to know". U. S. Fidelity & Guaranty Co. v. Goetz, 285 N.Y. 74, 32 N.E.2d 798 (1941); Morris v. Muir, 111 Misc. 739, 180 N.Y.S. 913 (1920).

2. Subsection (1)(a) refers to situations in which a certificated security indorsed "for collection" or "for surrender" is being offered for transfer and follows in effect Section 37 of the Negotiable Instruments Law, which provides that subsequent indorsees acquire only the title of the first indorsee under a restrictive indorsement.

3. A purchaser of an uncertificated security is charged with notice of adverse claims noted in the initial transaction statement. If the security is transferred to him other than by registration on the issuer's records, he is charged with notice of claims noted in the statement sent to the registered owner (or to the registered pledgee if his rights were transferred by notice to or acknowledgement from a registered pledgee).

Situations may arise in which the issuer receives notice of an adverse claim after registration of transfer, pledge or release but before the initial transaction statement is prepared and sent. The issuer ought not to note those claims on the statement. See Section 8-408(1)(d), (2)(d) and (3)(d). If the issuer should mistakenly note such a claim, subsection (2) does not charge the purchaser with notice.

4. In subsection (3) some situations involving purchase from one described or identifiable as a fiduciary are explicitly provided for, again imposing an objective standard, while leaving the door open to other circumstances which may constitute notice of adverse claims. Mere notice of the existence of the fiduciary relation is not enough in itself to prevent bona fide purchase, and the purchaser is free to take the security on the assumption that the fiduciary is acting properly. The fact that the security may be transferred to the individual account of the fiduciary or that the proceeds of the transaction are paid into that account in cash would not be sufficient to charge the purchaser with notice of potential breach of fiduciary obligation but as in State Bank of Binghamton v. Bache, 162 Misc. 128, 293 N.Y.S. 667 (1937) knowledge that the proceeds are being applied to the personal indebtedness of the fiduciary will charge the purchaser with such notice.

5. The notice here involved is to purchasers. A broker acting as such (Section 8-303) is treated in this section as a purchaser though he may not be a pur-

chaser under the definitions of that term (Section 1-201(33)). On the other hand, a bank, stock-broker or other intermediary who, in the particular transaction acts purely in that capacity, is not a purchaser. Cf. subsections (3) and (4) of Section 8-306 and Comments 3 and 4 to that Section. Subsection (3) follows the policy of Section 4 of the Uniform Fiduciaries Act and of Section 3-304 (2) with respect to commercial paper. Compare Section 7(a) of the Uniform Act for Simplification of Fiduciary Security Transfers.

The fact that the broker is expressly mentioned in this section carries no negative implication in other sections in which merely the word "purchaser" is used.

An issuer is not a purchaser. Its duty of inquiry is set forth in Part 4.

Cross References:

Point 5: Part 4 of this Article. See Sections 8-104, 8-302, 8-305 and 8-308.

Definitional Cross References:

"Adverse Claim". Section 8-302.
"Bearer Form". Section 8-102.
"Broker". Section 8-303.
"Certificated Security". Section 8-102.
"Indorsed". Section 8-308.
"Initial Transaction Statement". Section 8-408.
"Intermediary Bank". Section 4-105.
"Issuer". Section 8-201.
"Notice". Section 1-201.
"Person". Section 1-201.
"Purchaser". Section 1-201.
"Registered Form". Section 8-102.
"Security". Section 8-102.
"Uncertificated Security". Section 8-102.
"Writing". Section 1-201.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, designated the first paragraph as subsection (1), inserted "certificated" in the introductory language of subsection (1), substituted the present subsection (2) for the former subsection (2) which related to charging a purchaser with notice of adverse claims, and added subsection (3).

§ 25-8-305. Staleness as notice of adverse claims.

An act or event which creates a right to immediate performance of the principal obligation represented by a certificated security or which sets a date on or after which a certificated security is to be presented or surrendered for redemption or exchange does not of itself constitute any notice of adverse claims except in the case of a transfer:

(a) after one year from any date set for such presentment or surrender for redemption or exchange; or

(b) after six months from any date set for payment of money against presentation or surrender of the security if funds are available for payment on that date. (1899, c. 733, ss. 52, 53; Rev., ss. 2201, 2202; C.S., ss. 3033, 3034; 1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 52(2), 53, Uniform Negotiable Instruments Law.

Purposes:

1. The fact of "staleness" is viewed as notice of certain defects after the lapse of stated periods, but the maturity of the security does not operate automatically to affect holders' rights. The periods of time here stated are shorter than those appearing in the provisions of this Article on staleness as notice of defects or defenses (Section 8-203) since a purchaser who takes a security after funds or other securities are available for its redemption has more reason to suspect claims of ownership than issuer's defenses. An owner will normally turn in his security rather than transfer it at such a time.

Of itself, a default never constitutes notice of a possible adverse claim. To provide otherwise would not tend to drive defaulted securities home and would serve only to disrupt current financial markets where many defaulted securities are actively traded.

2. The owner is provided with a means of protecting himself while his security is being sent in for redemption or exchange. He may endorse it "for collection" or "for surrender," and this constitutes notice of his claims (Section 8-304). The present section does not come into operation unless the time period here stated has elapsed.

3. Unpaid or overdue coupons attached to a bond do not bring it within the operation of this section, although under some circumstances they may give the purchaser "reason to know" of claims of ownership. Georgia Granite R. Co. v. Miller, 144 Ga. 665, 87 S.E. 897 (1916).

4. This section has been made expressly applicable to certificated securities only, since the transfer of an uncertificated security normally will involve communication with the issuer and a consequent opportunity for the issuer to give the transferee effective notice of adverse claims.

Cross References:

Point 1: Section 8-203.
Point 2: Section 8-304. See Section 8-103.

Definitional Cross References:

"Adverse Claim". Section 8-302.
"Certificated Security". Section 8-102.
"Money". Section 1-201.
"Notice". Section 1-201.
"Purchase". Section 1-201.
"Right". Section 1-201.
"Security". Section 8-102.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, in the introductory language, substituted "represented by a certificated security" for "evidenced by the security," "a certificated security" for "the security," and "transfer" for "purchase."

§ 25-8-306. Warranties on presentment and transfer of certificated securities; warranties of originators of instructions.

(1) A person who presents a certificated security for registration of transfer or for payment or exchange warrants to the issuer that he is entitled to the registration, payment or exchange. But a purchaser for value without notice of adverse claims who receives a new, reissued or re-registered certificated security on registration of transfer or receives an initial transaction statement confirming the registration of transfer of an equivalent uncertificated security to him warrants only that he has no knowledge of any unauthorized signature (G.S. 25-8-311) in a necessary indorsement.

(2) A person by transferring a certificated security to a purchaser for value warrants only that

(a) His transfer is effective and rightful;
(b) The security is genuine and has not been materially altered; and
(c) He knows no fact which might impair the validity of the security.

(3) If a certificated security is delivered by an intermediary known to be entrusted with delivery of the security on behalf of another or with collection of a draft or other claim against such delivery, the intermediary by such delivery warrants only his own good faith and authority even though he has purchased or made advances against the claim to be collected against the delivery.

(4) A pledgee or other holder for security who redelivers a certificated security received, or after payment and on order of the debtor

delivers that security to a third person makes only the warranties of an intermediary under subsection (3).

(5) A person who originates an instruction warrants to the issuer that:

(a) He is an appropriate person to originate the instruction; and

(b) At the time the instruction is presented to the issuer he will be entitled to the registration of transfer, pledge, or release.

(6) A person who originates an instruction warrants to any person specially guaranteeing his signature (G.S. 25-8-312(3)) that:

(a) He is an appropriate person to originate the instruction; and

(b) At the time the instruction is presented to the issuer:

(i) He will be entitled to the registration of transfer, pledge, or release; and

(ii) The transfer, pledge, or release requested in the instruction will be registered by the issuer free from all liens, security interests, restrictions, and claims other than those specified in the instruction.

(7) A person who originates an instruction warrants to a purchaser for value and to any person guaranteeing the instruction (G.S. 25-8-312(6)) that:

(a) He is an appropriate person to originate the instruction;

(b) The uncertificated security referred to therein is valid; and

(c) At the time the instruction is presented to the issuer:

(i) The transferor will be entitled to the registration of transfer, pledge, or release;

(ii) The transfer, pledge, or release requested in the instruction will be registered by the issuer free from all liens, security interests, restrictions, and claims other than those specified in the instruction; and

(iii) The requested transfer, pledge, or release will be rightful.

(8) If a secured party is the registered pledgee or the registered owner of an uncertificated security, a person who originates an instruction of release or transfer to the debtor, or, after payment and on order of the debtor, a transfer instruction to a third person, warrants to the debtor or the third person only that he is an appropriate person to originate the instruction and, at the time the instruction is presented to the insurer, the transferor will be entitled to the registration of release or transfer. If a transfer instruction to a third person who is a purchaser for value is originated on order of the debtor, the debtor makes to the purchaser the warranties of paragraphs (b), (c)(ii) and (c)(iii) of subsection (7).

(9) A person who transfers an uncertificated security to a purchaser for value and does not originate an instruction in connection with the transfer warrants only that:

(a) His transfer is effective and rightful; and

(b) The uncertificated security is valid.

(10) A broker gives to his customer and to the issuer and a purchaser the applicable warranties provided in this section and has the rights and privileges of a purchaser under this section. The warranties of and in favor of the broker, acting as an agent, are in addition to applicable warranties given by and in favor of his customer. (1899, c. 733, ss. 65 to 67, 69; Rev., ss. 2214 to 2216, 2218;

C.S., ss. 3046 to 3048, 3050; 1941, c. 353, ss. 11, 12; G.S., ss. 55-91, 55-92; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 65, 66, 67, 69, Uniform Negotiable Instruments Law; Sections 11, 12, Uniform Stock Transfer Act.

Purposes:

1. The warranties with respect to certificated securities have been recognized by the prevailing case law as well as by the prior Acts cited. See Boston Tow Boat Co. v. Medford Nat. Bank, 232 Mass. 38, 121 N.E. 491 (1919); Burtch v. Child, Hulswit & Co., 207 Mich. 205, 174 N.W. 170 (1919).

Usual estoppel principles apply with respect to transfers of both certificated and uncertificated securities whenever the purchaser has knowledge of the defect, and these warranties will not be effective in such a case. In addition, under Section 1-102(3) these provisions apply only "unless otherwise agreed" and the parties are free to enter into any express agreement they desire where both are aware of possible defects.

2. The second sentence of subsection (1) limits the warranties made by a bona fide purchaser whose presentation of a certificated security is defective in some way but who nonetheless is given a reissued certificated security or an initial transaction statement confirming the transfer of an uncertificated security to him. The effect is to deny the issuer a remedy against such a person unless at the time of presentment the person had knowledge of an unauthorized signature in a necessary indorsement. The issuer can protect itself by refusing to make the transfer or, if it registers the transfer before it discovers the defect, by pursuing its remedy against a signature guarantor.

3. Subsections (3) and (4) are designed to eliminate all substantive warranties in the case of deliveries of certificated securities by intermediaries and pledgees. Such parties deal primarily with the draft or other claim and, having no access to direct knowledge about the security, they cannot be held to warrant its genuineness or validity. Subsection (8) similarly limits the warranties given by a secured party (or its agent) originating an instruction at the behest of the debtor.

4. The so-called "stock-broker" normally functions as a broker (see definition of "broker", Section 8-303) and on a few occasions another institution such as a bank may function as a broker — e.g. for a standard broker's commission or similar compensation. In those situations the warranties, rights and privileges of the broker are spelled out in subsection (10). Nevertheless either the so-called "stock-broker" or the bank can qualify for the protection given by subsections (3) and (4) to an "intermediary" where in the particular transaction it does not function as a broker — e.g. when it transfers securities on a customer's instructions, either without charge or for a nominal handling charge.

5. Subsection (5) establishes the rights of the issuer against one who originates an instruction (Section 8-308(4)) that is fraudulent or otherwise improper. The issuer's loss — which necessitates the remedy — arises only if the issuer registers the requested transfer, pledge or release and is subjected to liability for improper registration. See Section 8-404(3).

6. Subsection (6) sets forth the warranties made by the instruction originator to a person specially guaranteeing his signature. These warranties mirror those made by the special signature guarantor.

7. Subsection (7) sets forth the warranties made to a purchaser for value by one who originates an instruction. These warranties are quite similar to those made by one transferring a certificated security, subsection (2), the principal difference being the absolute warranty of validity. If upon receipt of the instruction the issuer should dispute the validity of the security, it seems proper to place the burden of proving validity upon the transferor. Because the guarantor of an instruction makes an absolute warranty of rightfulness, Section 8-312 (6), he is given the benefit of a similar warranty from the originator in subsection (7).

Cross References:

See Sections 1-102(3), 8-103, 8-301, 8-311 and 8-405.

Definitional Cross References:

"Adverse Claim". Section 8-302.
"Appropriate Person". Section 8-308.
"Broker". Section 8-303.
"Certificated Security". Section 8-102.
"Debtor". Section 9-105.
"Delivery". Section 1-201.
"Genuine". Section 1-201.
"Good Faith". Section 1-201.
"Indorsement". Section 8-308.
"Initial Transaction Statement". Section 8-408.
"Instruction". Section 8-308.
"Issuer". Section 8-201.
"Knowledge". Section 1-201.
"Notice". Section 1-201.
"Person". Section 1-201.
"Purchase". Section 1-201.
"Purchaser". Section 1-201.
"Secured Party". Section 9-105.
"Security". Section 8-102.
"Security Interest". Section 1-201.
"Unauthorized Signature". Section 1-201.
"Uncertificated Security". Section 8-102.
"Value". Section 1-201.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, added the language beginning "of certificated securities" at the end of the catchline; inserted "certificated" in the first and second sentences of subsection (1), and in the introductory language of subsection (2); inserted "or receives an initial transaction statement confirming the registration of transfer of an equivalent uncertificated security to him" in the second sentence of subsection (1); deleted "and" at the end of subdivision (2)(a); substituted "If a certificated security" for "Where a security" in subsection (3); substituted "a certificated security" for "the security" in subsection (4); deleted former subsection (5) relating to the warranties a broker gave his customer, the issuer and a purchaser; and added present subsections (5) through (10).

§ 25-8-307. Effect of delivery without indorsement; right to compel indorsement.

If a certificated security in registered form has been delivered to a purchaser without a necessary indorsement he may become a bona fide purchaser only as of the time the indorsement is supplied, but against the transferor the transfer is complete upon delivery and the purchaser has a specifically enforceable right to have any necessary indorsement supplied. (1899, c. 733, s. 49; Rev., s. 2198; C.S., s. 3030; 1941, c. 353, s. 9; G.S., s. 55-89; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 49, Uniform Negotiable Instruments Law; Section 9, Uniform Stock Transfer Act.

Purposes:

1. As between the parties the transfer of a certificated security is made complete upon delivery, but the transferee cannot become a bona fide purchaser of the security until indorsement is made. The indorsement does not operate retroactively, and notice may intervene between delivery and indorsement so as to prevent the transferee from becoming a bona fide purchaser. This Article rejects such cases as Bethea v. Floyd, 177 S.C. 521, 181 S.E. 721 (1935), certiorari denied, 296 U.S. 622, 56 S.Ct. 143, 80 L.Ed. 442, holding that the indorsement of a note delivered prior to maturity but indorsed thereafter took effect as of the date of delivery to permit the purchaser to become a holder in due course. Although a purchaser taking without a necessary indorsement may be subject to claims of ownership, any issuer's defense of which he had no notice at the time of delivery will be cut off, since the provisions of this Article protect all purchasers for value without notice (Section 8-202).

2. The transferee's right to compel an indorsement where a certificated secu-

rity has been delivered with intent to transfer is recognized in the case law and the Article of this Act on Documents of Title. See Coats v. Guaranty Bank & Trust Co., 170 La. 871, 129 So. 513 (1930), and Section 7-506 of this Act.

3. A proper indorsement is one of the requisites of transfer which a purchaser of a certificated security has a right to obtain (Section 8-316). A purchaser may not only compel an indorsement under that section but may also recover for any reasonable expense incurred by the transferor's failure to respond to the demand for an indorsement.

Cross References:

Point 1: Section 8-202.
Point 2: Section 7-506.
Point 3: Section 8-316. See Sections 8-302, 8-308 and 8-309.

Definitional Cross References:

"Bona Fide Purchaser". Section 8-302.
"Certificated Security". Section 8-102.
"Delivery". Section 1-201.
"Indorsement". Section 8-308.
"Purchaser". Section 1-201.
"Registered Form". Section 8-102.
"Right". Section 1-201.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, substituted "If a certificated security" for "Where a security" in the beginning of the section.

§ 25-8-308. Indorsements; instructions.

(1) An indorsement of a certificated security in registered form is made when an appropriate person signs on it or on a separate document an assignment or transfer of the security or a power to assign or transfer it or his signature is written without more upon the back of the security.

(2) An indorsement may be in blank or special. An indorsement in blank includes an indorsement to bearer. A special indorsement specifies to whom the security is to be transferred, or who has power to transfer it. A holder may convert a blank indorsement into a special indorsement.

(3) An indorsement purporting to be only of part of a certificated security representing units intended by the issuer to be separately transferable is effective to the extent of the indorsement.

(4) An "instruction" is an order to the issuer of an uncertificated security requesting that the transfer, pledge, or release from pledge of the uncertificated security specified therein be registered.

(5) An instruction originated by an appropriate person is:

(a) A writing signed by an appropriate person; or

(b) A communication to the issuer in any form agreed upon in a writing signed by the issuer and an appropriate person.

If an instruction has been originated by an appropriate person but is incomplete in any other respect, any person may complete it as authorized and the issuer may rely on it as completed even though it has been completed incorrectly.

(6) "An appropriate person" in subsection (1) means the person specified by the certificated security or by special indorsement to be entitled to the security.

(7) "An appropriate person" in subsection (5) means:

(a) For an instruction to transfer or pledge an uncertificated security which is then not subject to a registered pledge, the registered owner; or

(b) For an instruction to transfer or release an uncertificated security which is then subject to a registered pledge, the registered pledgee.

(8) In addition to the persons designated in subsections (6) and (7) of this section, "an appropriate person" in subsections (1) and (5) of this section includes:

(a) If the person designated is described as a fiduciary but is no longer serving in the described capacity, either that person or his successor;

(b) If the persons designated are described as more than one person as fiduciaries and one or more are no longer serving in the described capacity, the remaining fiduciary or fiduciaries, whether or not a successor has been appointed or qualified;

(c) If the person designated is an individual and is without capacity to act by virtue of death, incompetence, infancy, or otherwise, his executor, administrator, guardian, or like fiduciary;

(d) If the persons designated are described as more than one person as tenants by the entirety or with right of survivorship and by reason of death all cannot sign, the survivor or survivors;

(e) A person having power to sign under applicable law or controlling instrument; and

(f) To the extent that the person designated or any of the foregoing persons may act through an agent, his authorized agent.

(9) Unless otherwise agreed, the indorser of a certificated security by his indorsement or the originator of an instruction by his origination assume no obligation that the security will be honored by the issuer but only the obligations provided in G.S. 25-8-306.

(10) Whether the person signing is appropriate is determined as of the date of signing and an indorsement made by or an instruction originated by him does not become unauthorized for the purposes of this article by virtue of any subsequent change of circumstances.

(11) Failure of a fiduciary to comply with a controlling instrument or with the law of the state having jurisdiction of the fiduciary relationship, including any law requiring the fiduciary to obtain court approval of the transfer, pledge, or release, does not render his indorsement or an instruction originated by him unauthorized for the purposes of this Article. (1899, c. 733, ss. 22, 31 to 37, 64, 69; Rev., ss. 2179 to 2186, 2213, 2218; C.S., ss. 3011 to 3018, 3045, 3050; 1941, c. 353, s. 20; G.S., s. 55-100; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1989 (Reg. Sess., 1990), c. 1024, s. 9(c).)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 31 through 37, 64 through 69, Uniform Negotiable Instruments Law; Section 20, Uniform Stock Transfer Act.

Purposes:

1. The simplified method of indorsing certificated securities set forth in the Uniform Stock Transfer Act is continued in subsections (1) and (2). Although more than one special indorsement on a given certificated security is here made possible, the desire for dividends or interest, as the case may be, should operate to bring the security home for registration of transfer within a reasonable period of time. The usual form of assignment which appears in the back of a stock certificate or in a separate "power" may be filled up either in the form of an assignment, a power of attorney to transfer, or both. If it is not filled up at all but merely signed, the indorsement is in blank; if filled up either as an assignment or as a power of attorney to transfer, the indorsement is special.

2. Subsection (3) recognizes, in contradistinction to the rule under the Uniform Negotiable Instruments Law, the validity of a "partial" indorsement of a certificated security — e.g., as to fifty shares of the one hundred represented by a single certificate. The rights of a transferee under a partial indorsement to the status of a bona fide purchaser are left to the case law.

3. Subsections (4) and (5) together indicate that an instruction is an order from an "appropriate person" (subsection (7)) to the issuer demanding registration of some form of transfer of an uncertificated security. Functionally, presentation of an instruction is quite similar to the presentation of an indorsed certificate for re-registration. The instruction may be in the form of a writing signed by an appropriate person or in any other form agreed upon in writing by the issuer and an appropriate person. Allowing nonwritten forms of instructions will permit the development and employment of means of transmitting instructions electronically.

When a person originates an instruction in which he leaves a blank and the blank later is completed, subsection (5) gives the issuer the same rights it would have had against the originating person had that person completed the blank himself. This is true regardless of whether the person completing the instruction had authority to complete it. Compare Section 8-206 and its Comment, dealing with blanks left upon issue.

4. Subsections (6) and (7) give basic rules for determining who is an appropriate person to indorse a certificated security or to originate a transfer instruction for an uncertificated security. Subsection (8) defines the various situations in which persons other than those designated in subsections (6) and (7) will also be "appropriate persons." The provisions are not mutually exclusive; for example, the same certificated security may be effectively indorsed either by the registered owner under subsection (6) or by his agent under (8) (f). Paragraph (8) (a) is made explicitly alternative to make it clear that there is no conflict with paragraph (3) (a) of Section 8-403, permitting the issuer to rely on the continued power of a fiduciary to act where he is the registered owner and the issuer has not received written notice to the contrary. Similar protection is given to other persons dealing with the security. See also the Comment to Section 8-404.

Paragraphs (e) and (f) in particular are comprehensive. For example, where a "small estate statute" permits a widow to transfer a decedent's securities without administration proceedings, she would be "a person having power to sign under applicable law." Similarly, in the usual partnership case, the signature of a partner would be that of "a person having power to sign under . . . [a] . . . controlling instrument."

Indorsement or origination by "an appropriate person" is included in the scope of the guarantee of signature (Section 8-312). It is prerequisite to the issuer's duty to register a transfer (Section 8-401) and to his exoneration from liability for improper registration (Section 8-404).

5. Subsection (9) makes clear that the indorser of a certificated security and the originator of an instruction do not warrant that the issuer will honor the underlying obligation. In view of the nature of investment securities and the circumstances under which they are normally transferred, a transferor cannot be held to warrant as to the issuer's actions. As a transferor he, of course, remains liable for breach of the warranties set forth in this Article (Section 8-306).

6. Subsection (10) of this section makes the indorsement or instruction speak as of the date of signing. Section 8-312 on guaranty of signature and Section 8-402 on assurance that indorsements and instructions are effective apply the same reasoning. Thus, the signatures on a security indorsed by A during his lifetime or on behalf of X corporation by Y as president during has incumbency do not become "unauthorized" (Section 8-311) because A dies or Y is replaced as president by Z. Authority to deliver a certificated security and thus to complete the transfer is not covered by this section. Subsection (11) supplements Section 8-403(3)(b) by making it clear that certain matters go to rightfulness of the transfer rather than to the validity of the indorsement or instruction. An example is the failure of a duly appointed guardian to obtain a required court approval of the transfer. Such a guardian is an "appropriate person" under paragraph (8)(c) of this section, and his indorsement may be effective even though, e.g., a required court order is not obtained.

Cross References:

Point 1: Section 8-306.

Point 4: Section 8-312 and Part 4 of this Article.

Point 6: Sections 8-301, 8-302, 8-307, 8-309 and 8-312.

Definitional Cross References:

"Bearer". Section 1-201.
"Certificated Security". Section 8-102.
"Holder". Section 1-201.
"Honor". Section 1-201.
"Issuer". Section 8-201.
"Person". Section 1-201.
"Registered Form". Section 8-102.
"Security". Section 8-102.
"Sign". Section 1-201.
"Uncertificated Security". Section 8-102.
"Writing". Section 1-201.
"Written". Section 1-201.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, substituted the present catchline for "Indorsement, how made; special indorsement; indorser not a guarantor; partial assignment," and rewrote this section.

The 1989 (Reg. Sess., 1990) amendment, effective July 27, 1990, substituted "registered" for "registering" in subdivision (7)(b).

CASE NOTES

Cited in Lawing v. Lawing, 81 N.C. App. 159, 344 S.E.2d 100 (1986).

§ 25-8-309. Effect of indorsement without delivery.

An indorsement of a certificated security whether special or in blank does not constitute a transfer until delivery of the certificated security on which it appears or if the indorsement is on a separate document until delivery of both the document and the security. (1899, c. 733, s. 30; Rev., s. 2178; C.S., s. 3010; 1941, c. 353, ss. 1, 10; G.S., ss. 55-81, 55-90; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 30, Uniform Negotiable Instruments Law; Sections 1, 10, Uniform Stock Transfer Act.

Purposes:

1. There must be a voluntary parting with control in order to effect a valid transfer of a certificated security as between the parties. Levey v. Nason, 279 Mass. 268, 181 N.E. 193 (1932), and National Surety Co. v. Indemnity Insurance Co. of North America, 237 App.Div. 485, 261 N.Y.S. 605 (1933).

2. The provision in section 10 of the Uniform Stock Transfer Act that an attempted transfer without delivery amounts to a promise to transfer is here omitted. Even under the prior Act the effect of such a promise was left to the applicable law of contracts, and this Article by making no reference to such situations intends to achieve a similar result.

With respect to delivery there is no counterpart to Section 8-307 on right to compel indorsement, such as is envisaged in Johnson v. Johnson, 300 Mass. 24, 13 N.E.2d 788 (1938), where the transferee under a written assignment was given the right to compel a transfer of the certificate.

Cross References:

Point 2: Section 8-307. See Sections 8-202(4) and 8-313.

Definitional Cross References:

"Certificated Security". Section 8-102.
"Delivery". Section 1-201.
"Indorsement". Section 8-308.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, inserted "certificated" in two places.

§ 25-8-310. Indorsement of security in bearer form.

An indorsement of a certificated security in bearer form may give notice of adverse claims (G.S. 25-8-304) but does not otherwise affect any right to registration the holder may possess. (1899, c. 733, s. 40; Rev., s. 2189; C.S., s. 3021; 1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 40, Uniform Negotiable Instruments Law.

Purposes:

1. The concept of indorsement applies only to registered certificated securities, and a purported indorsement of bearer paper is normally of no effect.

An indorsement "for collection," "for surrender" or the like, charges a purchaser with notice of adverse claims (Section 8-304(1)(a)) but does not operate beyond this to interfere with any right the holder may otherwise possess to have the security registered in his name.

2. The provisions of Section 40 of the Negotiable Instruments Law as to the liability of special indorsers of bearer instruments have no applicability here since this Article negates the liability of indorsers as such upon the issuer's obligation (Section 8-308(9)).

Cross References:

Sections 8-304 and 8-308.

Definitional Cross References:

"Adverse Claims". Section 8-302.
"Bearer Form". Section 8-102.
"Certificated Security". Section 8-102.
"Holder". Section 1-201.
"Indorsement". Section 8-308.
"Notice". Section 1-201.
"Right". Section 1-201.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, inserted "certificated."

§ 25-8-311. Effect of unauthorized indorsement or instruction.

Unless the owner or pledgee has ratified an unauthorized indorsement or instruction or is otherwise precluded from asserting its ineffectiveness

(a) He may assert its ineffectiveness against the issuer or any purchaser other than a purchaser for value and without notice of adverse claims who has in good faith received a new, reissued or re-registered certificated security on registration of transfer or received an initial transaction statement confirming the registration of transfer, pledge, or release of an equivalent uncertificated security to him; and

(b) An issuer who registers the transfer of a certificated security upon the unauthorized indorsement or who registers the transfer, pledge, or release of an uncertificated security upon the unauthorized instruction is subject to liability for improper registration (G.S. 25-8-404). (1899, c. 733, s. 23;

Rev., s. 2171; C.S., s. 3003; 1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 23, Uniform Negotiable Instruments Law.

Purposes:

1. Most present day security purchases are made through brokers. The purchaser who normally receives and sees only a certificate security registered in his own name or an initial transaction statement addressed to him cannot realistically be held to have notice of or to have relied upon a forged or unauthorized indorsement on the original security transferred or upon the unauthorized instruction. A good faith purchaser who has received an initial transaction statement or a new, reissued or re-registered certificate is therefore protected. Compare Telegraph Co. v. Davenport, 97 U.S. 369, 24 L.Ed. 1047 (1878). That line of cases which has refused to apply this rule where the new security is still in the hands of the party to whom it was issued is expressly rejected. See Weniger v. Success Mining Co., 227 F. 548 (C.C.A. Utah 1915); Hambleton v. Central Ohio R.R. Co., 44 Md. 551 (1876).

2. The original owner of a security which has been transferred on the basis of a forged indorsement or instruction is protected by the issuer's liability for wrongful registration of transfer (Section 8-404). The issuer's duty to issue a similar security to the owner unless an overissue would result is made explicit in Part 4 of this Article, as is his obligation to purchase available securities on the open market for transfer to the owner where overissue is involved (see Section 8-104). Compare Prince v. Childs Co., 23 F.2d 605 (1928); West v. Tintic Standard Mining Co. 71 Utah 158, 263 P. 490, 56 A.L.R. 1190 (1928). The issuer's recourse is against the forger and the guarantor of the latter's signature, if any. But since the issuer has a right to require a guarantee of signature, a bona fide purchaser presenting the certificated security or instruction to the issuer should not be held liable on any implied warranty of title theory unless he knew of the forgery (Section 8-306).

3. A bond which has been registered as principal and subsequently is returned to bearer form is, at that point, a "new security" within the meaning of this Section.

Cross References:

Point 2: Sections 8-104, 8-306(1), 8-312 and Part 4 of this Article.

Definitional Cross References:

"Adverse Claim". Section 8-302.
"Certificated Security". Section 8-102.
"Good Faith". Section 1-201.
"Initial Transaction Statement". Section 8-408.
"Instruction". Section 8-308.
"Issuer". Section 8-201.
"Notice". Section 1-201.
"Purchaser". Section 1-201.
"Uncertificated Security". Section 8-102.
"Value". Section 1-201.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, inserted "or instruction" in the catchline; inserted "or pledgee," and "or instruction," in the introductory language; in subdivision (a), inserted "certificated," and substituted the language beginning "transfer or received" for "registration of transfer; and," and in subdivision (b), inserted "certificated" and the language beginning "or who registers" and ending "the unauthorized instruction."

§ 25-8-312. Effect of guaranteeing signature, indorsement or instruction.

(1) Any person guaranteeing a signature of an indorser of a certificated security warrants that at the time of signing:

(a) The signature was genuine;

(b) The signer was an appropriate person to indorse (G.S. 25-8-308); and

(c) The signer had legal capacity to sign.

(2) Any person guaranteeing a signature of the originator of an instruction warrants that at the time of signing:

(a) The signature was genuine;

(b) The signer was an appropriate person to originate the instruction (G.S. 25-8-308) if the person specified in the instruction as the registered owner or registered pledgee of the uncertificated security was, in fact, the registered owner or registered pledgee of the security, as to which fact the signature guarantor makes no warranty;

(c) The signer had legal capacity to sign; and

(d) The taxpayer identification number, if any, appearing on the instruction as that of the registered owner or registered pledgee was the taxpayer identification number of the signer or of the owner or pledgee for whom the signer was acting.

(3) Any person specially guaranteeing the signature of the originator of an instruction makes not only the warranties of a signature guarantor (subsection (2)) but also warrants that at the time the instruction is presented to the issuer:

(a) The person specified in the instruction as the registered owner or registered pledgee of the uncertificated security will be the registered owner or registered pledgee; and

(b) The transfer, pledge, or release of the uncertificated security requested in the instruction will be registered by the issuer free from all liens, security interests, restrictions, and claims other than those specified in the instruction.

(4) The guarantor under subsections (1) and (2) or the special guarantor under subsection (3) does not otherwise warrant the rightfulness of the particular transfer, pledge, or release.

(5) Any person guaranteeing an indorsement of a certificated security makes not only the warranties of a signature guarantor under subsection (1) but also warrants the rightfulness of the particular transfer in all respects.

(6) Any person guaranteeing an instruction requesting the transfer, pledge, or release of an uncertificated security makes not only the warranties of a special signature guarantor under subsection (3) but also warrants the rightfulness of the particular transfer, pledge, or release in all respects.

(7) No issuer may require a special guarantee of signature (subsection (3)), a guarantee of indorsement (subsection (5)), or a guarantee of instruction (subsection (6)) as a condition to registration of transfer, pledge, or release.

(8) The foregoing warranties are made to any person taking or dealing with the security in reliance on the guarantee, and the guarantor is liable to the person for any loss resulting from breach of the warranties. (1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. In subsection (1) the commonly accepted liability of the guarantor of the signature of the indorser of a certificated security, which includes a warranty of the authority of the signer to sign for the holder as well as of the capacity of the signer to sign, is made express so that issuers and their agents may have a clear understanding of the extent to which they may rely upon such guarantees.

2. Consistent with the coordinate provisions of Sections 8-308, 8-401 and 8-404, this Section provides that a signature guarantor warrants as to facts "at the time of signing."

3. Subsection (2) sets forth the warranties that can reasonably be expected from the guarantor of the signature of the originator of an instruction, who, though familiar with the signer, does not have before him any evidence that the purported owner or pledgee is, in fact, the owner or pledgee of the subject uncertificated security. This is in contrast to the position of the person guaranteeing a signature on a certificate who can see a certificate in the signer's possession in the name of or indorsed to the signer or in blank. Thus, the warranty of appropriateness in clause (b) is expressly conditioned on the actual registration's conforming to that represented by the originator. If the signer purports to be the owner or pledgee, the guarantor under clause (b), warrants only his identity. If, however, the signer is acting in a representative capacity, the guarantor warrants both his identity and his authority to act for the purported owner or pledgee. The additional warranty of clause (d) as to the taxpayer identification number is intended to prevent error or fraud resulting from identical or similar names. The warranties of subsection (2) are intended to provide satisfactory assurance to the issuer who needs no warranty as to the facts of registration because he can ascertain those facts from his own records.

4. Subsection (3) sets forth a "special guarantee of signature" under which the guarantor additionally warrants both registered ownership or pledge and freedom from undisclosed defects of record. The guarantor of the signature of an indorser of a certificated security effectively makes these warranties to a purchaser for value on the evidence of a clean certificate issued in the name of the indorser, indorsed to the indorser or indorsed in blank. By specially guaranteeing under subsection (3), the guarantor warrants that the instruction will, when presented to the issuer, result in the requested registration free from defects not specified. It is contemplated that the special guarantee of signature will be used principally in brokerage transactions where the broker will be specially guaranteeing the signature on an instruction originated by his own customer. The broker's risk will be no greater than that of a broker who executes the sale of a security for his customer without the absolute assurance that his customer will deliver a clean certificate at settlement.

5. Subsection (4) makes clear that the warranties of a person guaranteeing a signature are limited to those specified in this section and do not include a general warranty of rightfulness. On the other hand subsections (5) and (6) make clear that a person guaranteeing an indorsement or an instruction does warrant that the transfer is rightful in all respects.

6. Subsection (7) makes clear what can be inferred from the combination of Sections 8-401 and 8-402, that the issuer may not require as a condition to transfer a guarantee of the indorsement or instruction nor may it require a special signature guarantee. But the voluntary furnishing of such a guarantee and its acceptance by the issuer may save the time and expense of an inquiry into possible adverse claims (cf. Section 8-403).

7. Subsection (8) is expressly designed to encourage issuers and their agents to rely upon signature guarantees and to avoid needless waste of time and duplication of effort in ascertaining the facts so guaranteed.

Cross References:

Point 1: Section 8-308. See Part 4 of this Article.

Definitional Cross References:

"Appropriate Person". Section 8-308.
"Certificated Security". Section 8-102.
"Genuine". Section 1-201.
"Indorsement". Section 8-308.
"Instruction". Section 8-308.
"Issuer". Section 8-201.

"Person". Section 1-201.
"Security". Section 8-102.
"Security Interest". Section 1-201.
"Sign". Section 1-201.
"Uncertificated Security". Section 8-102.

Effect of Amendments. — The 1989, amendment, effective October 1, 1989, substituted "indorsement or instruction" for "or indorsement" in the catchline, and rewrote this section.

§ 25-8-313. When transfer to purchaser occurs; financial intermediary as bona fide purchaser; "financial intermediary".

(1) Transfer of a security or a limited interest (including a security interest) therein to a purchaser occurs only:

(a) At the time he or a person designated by him acquires possession of a certificated security;

(b) At the time the transfer, pledge, or release of an uncertificated security is registered to him or a person designated by him;

(c) At the time his financial intermediary acquires possession of a certificated security specially indorsed to or issued in the name of the purchaser;

(d) At the time a financial intermediary, not a clearing corporation, sends him confirmation of the purchase and also by book entry or otherwise identifies as belonging to the purchaser:

  (i) A specific certificated security in the financial intermediary's possession;

  (ii) A quantity of securities that constitute or are part of a fungible bulk of certificated securities in the financial intermediary's possession or of uncertificated securities registered in the name of the financial intermediary; or

  (iii) A quantity of securities that constitute or are part of a fungible bulk of securities shown on the account of the financial intermediary on the books of another financial intermediary.

(e) With respect to an identified certificated security to be delivered while still in the possession of a third person, not a financial intermediary, at the time that person acknowledges that he holds for the purchaser;

(f) With respect to a specific uncertificated security the pledge or transfer of which has been registered to a third person, not a financial intermediary, at the time that person acknowledges that he holds for the purchaser;

(g) At the time appropriate entries to the account of the purchaser or a person designated by him on the books of a clearing corporation are made under G.S. 25-8-320;

(h) With respect to the transfer of a security interest where the debtor has signed a security agreement containing a description of the security, at the time a written notification, which, in the case of the creation of the security interest, is signed by the debtor (which may be a copy of the security agreement) or which, in the case of the release or assignment of the security interest created pursuant to this paragraph, is signed by the secured party, is received by:

(i) A financial intermediary on whose books the interest of the transferor in the security appears;

(ii) A third person, not a financial intermediary, in possession of the security, if it is certificated;

(iii) A third person, not a financial intermediary, who is the registered owner of the security, if it is uncertificated and not subject to a registered pledge; or

(iv) A third person, not a financial intermediary, who is the registered pledgee of the security, if it is uncertificated and subject to a registered pledge.

(i) With respect to the transfer of a security interest where the transferor has signed a security agreement containing a description of the security, at the time new value is given by the secured party; or

(j) With respect to the transfer of a security interest where the secured party is a financial intermediary and the security has already been transferred to the financial intermediary under paragraphs (a), (b), (c), (d), or (g), at the time the transferor has signed a security agreement containing a description of the security and value is given by the secured party.

(2) The purchaser is the owner of a security held for him by a financial intermediary, but cannot be a bona fide purchaser of a security so held except in the circumstances specified in paragraphs (c), (d)(i), and (g) of subsection (1). If a security so held is part of a fungible bulk, as in the circumstances specified in paragraph (d)(ii) and (d)(iii) of subsection (1), the purchaser is the owner of a proportionate property interest in the fungible bulk.

(3) Notice of an adverse claim received by the financial intermediary or by the purchaser after the financial intermediary takes delivery of a certificated security as a holder for value or after the transfer, pledge, or release of an uncertificated security has been registered free of the claim to a financial intermediary who has given value is not effective either as to the financial intermediary or as to the purchaser. However, as between the financial intermediary and the purchaser, the purchaser may demand transfer of an equivalent security as to which no notice of adverse claim has been received.

(4) A "financial intermediary" is a bank, broker, clearing corporation, or other person (or the nominee of any of them) which in the ordinary course of its business maintains security accounts for its customers and is acting in that capacity. A financial intermediary may have a security interest in securities held in account for its customer. (1899, c. 733, s. 191; Rev., s. 2340; C.S., s. 2976; 1941, c. 353, s. 22; G.S., s. 55-102; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1991, c. 636, s. 4(a), (b).)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 191, Uniform Negotiable Instruments Law; Section 22, Uniform Stock Transfer Act.

Purposes:

1. Subsection (1) lists the various methods by which legal rights in a security may be transferred from one person to another. Subsection (1) is expressly made applicable to limited interests, including security interests, as well as to entire interests. Compare Section 8-301(2). The word "only" in the first

sentence is intended to provide that the methods of transfer listed are exclusive and that compliance with one of them is essential to a valid transfer. Transfers by operation of law are excepted because they are not transfers to a "purchaser".

2. This section is intended to bring the law of securities transfers into line with modern security trading practices and to allow for future development of those practices. It is recognized that most transfers are not effected through physical delivery of a certificate from seller to buyer, but rather through adjustments in balances of the parties' accounts with various intermediaries. Whether each intermediary has physical possession of a certificate to match every security it "holds" in its customer accounts is of no importance. So long as the intermediary exercises ultimate control, the securities may equally well take the form of an account with a securities depository, with another intermediary or with a transfer agent.

Thus a "financial intermediary," which as defined in subsection (4) must be a person that as part of its ordinary business "maintains security accounts" for its customers, must control the disposition of securities pursuant to its customers' orders but may exercise its control in any of a number of forms — e. g. maintaining possession of certificated securities, being registered owner or registered pledgee of uncertificated securities, or having its own account with another financial intermediary. The important factor is that the intermediary must "hold" securities in an account for the customer. Notice that one who is a professional agent for holding securities accounts is not a financial intermediary with respect to any particular transaction in which it is not holding securities in an account for its customer. For example, a bank may as part of its business hold securities in accounts for its customers and therefore hold as a financial intermediary with respect to those accounts; but if it takes a pledge of securities not held in account for the borrower to secure a loan, it is not a financial intermediary with respect to the securities pledged, since it holds the securities for its *own* account rather than for a customer. On the other hand, a broker is a financial intermediary with respect to a margin account, since even though it has a personal interest in the securities, it holds securities in an account for a customer.

3. Paragraphs (a) and (b) of subsection (1) describe the most basic forms of transfer for certificated and uncertificated securities respectively. Paragraph (d) is the basic provision for transfers effected through entries in the records of a financial intermediary. For a valid transfer to be effected there must be both an entry made in the records and a confirmation sent to the purchaser. Confirmation is required to ensure that evidence exists to prove that the securities are held by the intermediary in a customer account rather than for its own account. This provision is important principally with regard to potential insolvency of an intermediary. So long as the financial intermediary holds the securities in an account, the *form* in which it "holds" the securities makes no difference to the effectuation of a transfer. The form does, however, make a difference as to whether the purchaser can become a bona fide purchaser. See subsection (2) and Section 8-302(1)(c).

Paragraphs (e) and (f) of subsection (1) provide for transfers of certificated and uncertificated securities held by a "third person" who is not a financial intermediary. Acknowledgement by that person that he holds for the purchaser is the only condition to the transfer. Requiring acknowledgement forces the transferee to have the arrangement made explicit.

Paragraph (g) sets forth the requirements for a transfer of a security held by a clearing corporation. The transfer occurs when the appropriate entries are made. No confirmation is required, since the fact that a clearing corporation holds no securities for its own account eliminates the possibility that customers' securities might be intermingled with securities owned by the clearing corporation.

Paragraphs (h), (i) and (j) relate only to transfers of security interests. Paragraph (h) is analogous to Section 9-305, which provides the rule for perfecting a security interest in property in the possession of a bailee. Paragraph (h) makes explicit that if the transferor's interest is in an account with a financial intermediary, that intermediary is the proper person to receive notice of the transfer regardless of whether it has physical possession or registration in its own name or whether it has securities in an account with another intermediary. The notification to the "bailee" must be written and must be signed by the debtor or by the secured party, according to whether the security interest is being created or released. The transfer is also conditioned upon the existence of a written security agreement signed by the debtor and adequately identifying the security. This requirement is included in paragraph (h) because Section 8-321, which sets forth the requirements for creation and perfection of security interests, gives no formality requirements other than the existence of a valid transfer.

Paragraph (i) is similar to Section 9-304(4). Read in conjunction with Section 8-321, it provides for "automatic" perfection for 21 days after new value is given with respect to a security interest as to which the debtor has signed a security agreement.

Paragraph (j) also deals only with the creation of security interests. In conjunction with Section 8-321, it provides that a financial intermediary that already controls disposition of a security may take a perfected security interest by giving value and having the debtor sign a security agreement.

4. Subsection (2) sets forth the principle that a purchaser is the owner of any security "held for him" — i. e. controlled pursuant to his instructions — by a financial intermediary. For example, a purchaser owns the securities in his custody account with a bank or his margin account with a broker. However, unless specific securities are separately identified as belonging to the purchaser, he cannot become a bona fide purchaser. A bona fide purchaser takes particular securities free of all claims and defenses. If bona fide purchaser status were given to those whose securities are held as part of a fungible bulk, there would be a possibility of inconsistent claims between two or more bona fide purchasers, since if the bulk should prove to be smaller than was expected, the claim of one or both must be compromised. An exception is made with respect to securities held by clearing corporations, since the fact that those entities hold *only* for customer accounts makes the chance of inconsistent claims small. Securities held by intermediaries pursuant to paragraphs (c) and (d)(i) of subsection (1) are identifiable as belonging to a particular customer, and the customer therefore can be a bona fide purchaser. Those customers that are not bona fide purchasers own a proportionate property interest in the bulk of securities of that nature held by the intermediary. Thus the group of customers together own the entire bulk, and in the event of insolvency of the intermediary they would as a group be secured to the extent the bulk covered their ownership claims. If the bulk were insufficient to provide each customer his full claim, each would share ratably.

5. Subsection (3) provides protection to both financial intermediary and customer whenever notice of an adverse claim is received after the intermediary takes delivery of a certificated security as a holder for value or after the transfer, pledge or release of an uncertificated security has been registered free of the claim to a financial intermediary. It also states the principle that as between the intermediary and its customer, the latter is entitled to a "clean" security, i. e. one as to which no notice of adverse claim has been received. Isham v. Post, 141 N.Y. 100, 35 N.E. 1084, 23 L.R.A. 90 (1894), which permitted a broker acting as agent to deliver to his customer a security as to which a claim of forgery was made after its receipt by the broker, is rejected. An intermediary is in the business of handling securities. It is better equipped to clear up any questions of genuineness or adverse claim, and even though it acts in whole or in part as agent for its customer, it is not permitted to pass such problems on to its customer. However if the problem arises because of the customer's own act or omission to act, he is estopped to rely on it as a basis for rejecting the security. Section 1-103.

Cross References:

Sections 8-301, 8-302, 8-314, 8-315, 8-320, 8-321, 9-304(4) and 9-305.

Definitional Cross References:

"Adverse Claim". Section 8-302.
"Bona Fide Purchaser". Section 8-302.
"Certificated Security". Section 8-102.
"Clearing Corporation". Section 8-102.
"Debtor". Section 9-105.
"Delivery". Section 1-201.
"Fungible". Section 1-201.
"Holder". Section 1-201.
"Indorsed". Section 8-308.
"Notice". Section 1-201.
"Notification". Section 1-201.
"Person". Section 1-201.
"Purchase". Section 1-201.
"Purchaser". Section 1-201.
"Secured Party". Section 9-105.
"Security". Section 8-102.
"Security Agreement". Section 9-105.

"Security Interest". Section 1-201.
"Send". Section 1-201.
"Signed". Section 1-201.
"Uncertificated Security". Section 8-102.
"Value". Section 1-201.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, substituted the present catchline for "When delivery to the purchaser occurs; purchaser's broker as holder," and rewrote this section.

The 1991 amendment, effective July 11, 1991, substituted "transferor" for "transfer" in subdivision (1)(j) and substituted "paragraphs (c), (d)(i), and (g)" for "paragraphs (c), (d), (i), and (g)" in subdivision (2).

§ 25-8-314. Duty to transfer, when completed.

(1) Unless otherwise agreed, if a sale of a security is made on an exchange or otherwise through brokers:

(a) The selling customer fulfills his duty to transfer at the time he:

(i) Places a certificated security in the possession of the selling broker or a person designated by the broker;

(ii) Causes an uncertificated security to be registered in the name of the selling broker or a person designated by the broker;

(iii) If requested, causes an acknowledgment to be made to the selling broker that a certificated or uncertificated security is held for the broker; or

(iv) Places in the possession of the selling broker or of a person designated by the broker a transfer instruction for an uncertificated security, providing the issuer does not refuse to register the requested transfer if the instruction is presented to the issuer for registration within 30 days thereafter; and

(b) The selling broker, including a correspondent broker acting for a selling customer, fulfills his duty to transfer at the time he:

(i) Places a certificated security in the possession of the buying broker or a person designated by the buying broker;

(ii) Causes an uncertificated security to be registered in the name of the buying broker or a person designated by the buying broker;

(iii) Places in the possession of the buying broker or of a person designated by the buying broker a transfer instruction for an uncertificated security, providing the issuer does not refuse to register the requested transfer if the instruction is presented to the issuer for registration within 30 days thereafter; or

(iv) Effects clearance of the sale in accordance with the rules of the exchange on which the transaction took place.

(2) Except as provided in this section or unless otherwise agreed, a transferor's duty to transfer a security under a contract of purchase is not fulfilled until he:

(a) Places a certificated security in form to be negotiated by the purchaser in the possession of the purchaser or of a person designated by the purchaser;

(b) Causes an uncertificated security to be registered in the name of the purchaser or a person designated by the purchaser; or

(c) If the purchaser requests, causes an acknowledgment to be made to the purchaser that a certificated or uncertificated security is held for the purchaser.

(3) Unless made on an exchange, a sale to a broker purchasing for his own account is within subsection (2) and not within subsection (1). (1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. This section, together with the section on warranties to the purchaser (Section 8-306) and the section on transfer to the purchaser (Section 8-313), states the rights and duties of the parties involved in the transfer of a security from the original transferor to the ultimate purchaser. Particular emphasis has been placed upon transactions on organized exchanges or through brokers or dealers since they account for the great bulk of security sales. Normally the sale of a security on such an exchange or through brokers involves at least three intermediate transactions, and perhaps more, depending upon the number of correspondent brokers concerned. Rarely is the same security transferred through the entire transaction, and the duty of each intermediate party in the chain of transfer must therefore be stated. The increased use of clearing houses is also recognized — in subparagraph (1)(b)(iv) a selling broker is specifically permitted to make delivery by clearing the sale through such a clearing agency.

2. Subparagraphs (1)(a)(i), (1)(a)(ii), (1)(b)(i) and (1)(b)(ii) set forth the basic methods of fulfilling the duty to transfer in exchange transactions. The selling customer can fulfill his duty by physically delivering a certificated security to the selling broker or by effecting the transfer of an uncertificated security to him on the records of the issuer. Similarly the selling broker can satisfy its duty to transfer to the buying broker by delivering a certificate or causing registration of an uncertificated security. Further, with respect to exchange transactions subparagraphs (a)(iv) and (b)(iii) of subsection (1) provide that the duty to transfer can be conditionally satisfied by the delivery of an instruction. Such delivery does not constitute complete performance if the instruction is timely presented for registration and the issuer refuses to comply with its request. The burden of timely presentment is placed on the recipient of the instruction and it is not intended that instructions so given will circulate in the manner in which certificated securities now commonly circulate by indorsement. It is contemplated that this method of performance will be commonly employed in transactions settled through brokers, with, in many cases, the selling broker specially guaranteeing the signature of the originator of the instruction pursuant to Section 8-312(3).

3. Under subsection (2), absent agreement, one transferring a security to a purchaser in a transaction not consummated on an exchange or through brokers must either make physical delivery of a certificated security or cause the registration of transfer of an uncertificated security. Further, at the request of the purchaser he can satisfy his duty by causing acknowledgement to be given to the purchaser by a third person who controls the security (Section 8-313(1)(d) and (e)). He cannot, for example, just put a certificated security in transit and impose the risk of loss upon the recipient; nor can he fulfill his duty by delivering to the purchaser a transfer instruction.

4. Subsection (3) covers the situation in which one in business as a broker is, in the particular transaction, his own customer. When he buys or sells for a customer other than himself, whether as agent or as principal, he is a "broker" under this Article (Section 8-303) and the transaction is within subsection (1) of this section.

Cross References:
Sections 8-303, 8-306 and 8-313.

Definitional Cross References:
"Agreed". Section 1-201.
"Broker". Section 8-303.

"Certificated Security". Section 8-102.
"Contract". Section 1-201.
"Instruction". Section 8-308.
"Issuer". Section 8-201.
"Person". Section 1-201.
"Purchase". Section 1-201.
"Purchaser". Section 1-201.
"Security". Section 8-102.
"Uncertificated Security". Section 8-102.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, substituted "Duty to transfer" for "Duty to Delivery [sic]" in the catchline, and rewrote this section.

§ 25-8-315. Action against transferee based upon wrongful transfer.

(1) Any person against whom the transfer of a security is wrongful for any reason, including his incapacity, as against anyone except a bona fide purchaser, may:

(a) Reclaim possession of the certificated security wrongfully transferred;

(b) Obtain possession of any new certificated security representing all or part of the same rights;

(c) Compel the origination of an instruction to transfer to him or a person designated by him an uncertificated security constituting all or part of the same rights; or

(d) Have damages.

(2) If the transfer is wrongful because of an unauthorized indorsement of a certificated security, the owner may also reclaim or obtain possession of the security or a new certificated security, even from a bona fide purchaser, if the ineffectiveness of the purported indorsement can be asserted against him under the provisions of this Article on unauthorized indorsements (G.S. 25-8-311).

(3) The right to obtain or reclaim possession of a certificated security or to compel the origination of a transfer instruction may be specifically enforced and the transfer of a certificated or uncertificated security enjoined and a certificated security impounded pending the litigation. (1941, c. 353, s. 7; G.S., s. 55-87; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 7, Uniform Stock Transfer Act.

Purposes:

1. This Section grants to all owners of securities — certificated or uncertificated — a remedy for wrongful transfer. The general rule permitting an owner to reclaim possession of a certificated security wrongfully transferred is continued in paragraph (1)(a). Also, the owner of either a certificated or uncertificated security that has been wrongfully transferred may obtain a certificated security representing the same rights or may compel the origination of an effective transfer instruction for an uncertificated security comprising the same rights. Finally, the owner may have damages.

An exception is made, as in the prior law, in favor of bona fide purchasers. However, where the transfer is based upon a forged or unauthorized indorsement the exception operates in favor only of a good faith purchaser who is protected by Section 8-311. See that section and the comments thereto.

2. This section is not intended to exclude any rights an owner may have to damages for conversion under the case law. But see Section 8-318, which protects innocent brokers and other agents and bailees from liability for conversion.

Cross References:
Sections 8-302, 8-311 and 8-318.

Definitional Cross References:
"Action". Section 1-201.
"Bona Fide Purchaser". Section 8-302.
"Certificated Security". Section 8-102.
"Indorsement". Section 8-308.
"Instruction". Section 8-308.
"Person". Section 1-201.
"Right". Section 1-201.
"Security". Section 8-102.
"Unauthorized Indorsement". Section 1-201.
"Uncertificated Security". Section 8-102.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, substituted "transferee" for "purchaser" in the catchline, and rewrote this section.

§ 25-8-316. Purchaser's right to requisites for registration of transfer, pledge, or release on books.

Unless otherwise agreed, the transferor of a certificated security or the transferor, pledgor, or pledgee of an uncertificated security on due demand shall supply his purchaser with any proof of his authority to transfer, pledge, or release or with any other requisite necessary to obtain registration of the transfer, pledge, or release of the security; but if the transfer, pledge, or release is not for value, a transferor, pledgor, or pledgee need not do so unless the purchaser furnishes the necessary expenses. Failure within a reasonable time to comply with a demand made gives the purchaser the right to reject or rescind the transfer, pledge, or release. (1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. The registration of the transfer of a security is a matter of vital importance to a purchaser and he is here provided with the means of obtaining such formal requirements for registration as signature guarantees, proof of authority, transfer tax stamps and the like. The transferor is the one in a position to supply most conveniently whatever documentation may be requisite for registration of transfer, and his duty to do so upon demand within a reasonable time is here stated affirmatively. But if the transfer is not for value the transferee should pay expenses. For these purposes a release from pledge by a secured party to a debtor is a transfer for value.

2. If the transferor's duty is not performed the transferee may reject or rescind the contract to transfer, pledge or release. He is not bound to do so — he may prefer his action for damages for breach of contract. If an essential item is peculiarly within the province of the transferor so that he is the only one who can obtain it, the purchaser may specifically enforce his right. Compare Section 8-307.

Cross References:
Section 8-307.

Definitional Cross References:
"Certificated Security". Section 8-102.
"Purchaser". Section 1-201.
"Reasonable Time". Section 1-204.
"Right". Section 1-201.
"Security". Section 8-102.
"Uncertificated Security". Section 8-102.
"Value". Section 1-201.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, inserted "pledge, or release" in the catchline, and rewrote this section.

§ 25-8-317. Creditors' rights.

(1) Subject to the exceptions in subsections (3) and (4) of this section, no attachment or levy upon a certificated security or any share or other interest represented thereby which is outstanding is valid until the security is actually seized by the officer making the attachment or levy, but a certificated security which has been surrendered to the issuer may be reached by a creditor by legal process at the issuer's chief executive office in the United States.

(2) An uncertificated security registered in the name of the debtor may not be reached by a creditor except by legal process at the issuer's chief executive office in the United States.

(3) The interest of a debtor in a certificated security that is in the possession of a secured party not a financial intermediary or in an uncertificated security registered in the name of a secured party not a financial intermediary (or in the name of a nominee of the secured party) may be reached by a creditor by legal process upon the secured party.

(4) The interest of a debtor in a certificated security that is in the possession of or registered in the name of a financial intermediary or in an uncertificated security registered in the name of a financial intermediary may be reached by a creditor by legal process upon the financial intermediary on whose books the interest of the debtor appears.

(5) Unless otherwise provided by law, a creditor's lien upon the interest of a debtor in a security obtained pursuant to subsection (3) or (4) of this section is not a restraint on the transfer of the security, free of the lien, to a third party for new value; but in the event of a transfer, the lien applies to the proceeds of the transfer in the hands of the secured party or financial intermediary, subject to any claims having priority.

(6) A creditor whose debtor is the owner of a security is entitled to aid from courts of appropriate jurisdiction, by injunction or otherwise, in reaching the security or in satisfying the claim by means allowed at law or in equity in regard to property that cannot readily be reached by ordinary legal process. (1941, c. 353, ss. 13, 14; G.S., ss. 55-93, 55-94; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1991, c. 636, s. 4(c); 1991 (Reg. Sess., 1992), c. 1030, s. 13.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 13, 14, Uniform Stock Transfer Act.

Purposes:

1. In dealing with certificated securities the instrument itself is the vital thing, and therefore a valid levy cannot be made unless all possibility of the security's wrongfully finding its way into a transferee's hands has been removed. This can be accomplished only when the security is in the possession of a public officer, the issuer, or an independent third party. A debtor who has been enjoined can still transfer the security in contempt of court. See Overlock v. Jerome-Portland Copper Mining Co., 29 Ariz. 560, 243 P. 400 (1926). Therefore, although injunctive relief is provided in subsection (6) so that creditors may use this method to gain control of the security, the security itself must be reached to constitute a proper levy whenever the

debtor has possession. The method used in Hodes v. Hodes, 176 Or. 102, 155 P.2d 564 (1945), where the Oregon court enjoined the transfer of a security in a safe deposit box in the state of Washington, directing a copy of the writ to be served upon the issuer, although not operative as an effective levy, is a method of reaching the security approved by the section.

2. Whenever the security is not in the form of a negotiable instrument in the debtor's possession, an effective levy can be made by serving process upon the person controlling transfer. Thus subsection (2) provides that when the security is uncertificated and registered in the debtor's name — or, what in effect is the same situation, whenever a certificated security is in the issuer's possession (Section 8-102(1)(c)) — levy can be made only by serving process upon the issuer. The most logical place to serve the issuer would be the place where the transfer records are maintained, but that location might be difficult to identify, especially when the separate elements of a computer network might be situated in different places. The chief executive office is selected as the appropriate place by analogy to Section 9-103(3)(d). See Comment 5(c) to that section.

This section indicates only how attachment is to be made, not when it is legally justified. For that reason there is no conflict between this section and Shaffer v. Heitner, 433 U.S. 186, 97 S.Ct. 2569, 53 L.Ed.2d 683 (1977).

3. An attachment filed at the issuer's office against certificated securities is ineffective unless the security itself has been surrendered to the issuer. The case law holdings that priority in time of transfer or attachment governed the validity of the levy are rejected under this Article as under the Stock Transfer Act. See for example, National Bank of the Pacific v. Western Pac. R. Co., 157 Cal. 573, 108 P. 676, 27 L.R.A., N.S., 987, 21 Ann.Cas. 1391 (1910).

4. Subsection (3) provides that when a security, either certificated or uncertificated, is controlled by a secured party, an effective lien can be established by service on the secured party. This section does not attempt to provide for rights as between the creditor and the secured party, as, for example, whether or when the secured party must liquidate the security.

Subsection (4) recognizes that securities are frequently held in account for customers by banks or brokers and that such securities may be registered not only in the name of the debtor but, more commonly, in street or other nominee name. Additionally, in such cases, the securities may have been commingled, repledged or deposited so that no particular security could be identified as that of the debtor. The subsection provides that the debtor's account can be reached by process upon the entity upon whose books the interest of the debtor appears. This appears to be the most effective way of preventing the transfer of the debtor's interest and thus protecting the creditor. It is only that entity that is aware of the debtor's interest, irrespective of where the securities are located or in what name they happen to be registered.

Subsection (5) expressly provides that securities in which the debtor's interest is reached pursuant to subsection (3) or (4) may be transferred for new value, free of the creditor's lien, but also provides that when and if they are transferred, the lien will be transferred to the proceeds. Nothing in subsection (5) is intended to validate any transfer that would otherwise constitute a fraudulent conveyance. Furthermore, subsection (5) is expressly subject to the procedural laws of the states, and no attempt has been made to prescribe the consequences of obtaining such a lien or the procedures for its enforcement.

5. Particular terms to describe creditor's process have been avoided in this section. This section is not intended to have any effect on the availability of garnishment or similar third-party process as a pre-judgment or post-judgment remedy. Cf. Sniadach v. Family Finance Corp., 395 U.S. 337, 23 L.Ed.2d 349, 89 S.Ct. 1820 (1969); Fuentes v. Shevin, 407 U.S. 67, 32 L.Ed.2d 556, 92 S.Ct. 1983 (1972); Mitchell v. W. T. Grant Co., 416 U.S. 600, 40 L.Ed.2d 406, 94 S.Ct. 1895 (1974). Such matters are a proper concern of the procedural rules of the states, subject, of course, to constitutional limitations.

6. This section deals with the problems of attaching or levying creditors. It does not apply in cases where a governmental agency, for reasons of public safety or the like, seeks to confiscate securities. See, for example, the situation in Silesian American Corp. v. Clark, 332 U.S. 469, 68 S.Ct. 179, 92 L.Ed. 81

(1947), upon which this section has no bearing.

Definitional Cross References:

"Certificated Security". Section 8-102.
"Creditor". Section 1-201.
"Debtor". Section 9-105.
"Financial Intermediary". Section 8-313.
"Issuer". Section 8-201.
"Secured Party". Section 9-105.
"Security". Section 8-102.
"Uncertificated Security". Section 8-102.
"Value". Section 1-201.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, substituted the present catchline for "Attachment or levy upon security," and rewrote this section.

The 1991 amendment, effective July 11, 1991, substituted "interest" for "interests" near the end of subdivision (4).

The 1991 (Reg. Sess., 1992) amendment, effective July 24, 1992, substituted "uncertificated" for "uncertified" in subdivision (2).

§ 25-8-318. No conversion by good faith conduct.

An agent or bailee who in good faith (including observance of reasonable commercial standards if he is in the business of buying, selling or otherwise dealing with securities) has received certificated securities and sold, pledged or delivered them or has sold or caused the transfer or pledge of uncertificated securities over which he had control according to the instructions of his principal is not liable for conversion or for participation in breach of fiduciary duty although the principal had no right to so deal with the securities. (1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

This Section negates the liability of agents, including brokers, and of bailees for innocent conversion or participation in breach of fiduciary duty. Gruntal v. National Surety Co., 254 N.Y. 468, 173 N.E. 682 (1930) is followed. Compare Section 7(a) of the Uniform Act for Simplification of Fiduciary Security Transfers.

Notice that the concept of good faith includes the objective element of observing reasonable commercial standards when the agent or bailee is in the business of dealing with securities.

Cross Reference:

Section 7-404.

Definitional Cross References:

"Certificated Security". Section 8-102.
"Delivery". Section 1-201.
"Good Faith". Section 1-201.
"Security". Section 8-102.
"Unsecured Security". Section 8-102.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, substituted "conduct" for "delivery" in the catchline, and inserted "certificated," inserted "or has sold or caused the transfer or pledge of uncertificated securities over which he had control," and substituted "to so deal with the securities" for "to dispose of them."

§ 25-8-319. Statute of frauds.

A contract for the sale of securities is not enforceable by way of action or defense unless

(a) There is some writing signed by the party against whom enforcement is sought or by his authorized agent or broker sufficient to indicate that a contract has been made for sale of a stated quantity of described securities at a defined or stated price;

(b) Delivery of a certificated security or transfer instruction has been accepted, or transfer of an uncertificated security has been registered and the transferee has failed to send written objection to the issuer within 10 days after receipt of the initial transaction statement confirming the registration, or payment has been made but the contract is enforceable under this provision only to the extent of such delivery or payment;

(c) Within a reasonable time a writing in confirmation of the sale or purchase and sufficient against the sender under paragraph (a) has been received by the party against whom enforcement is sought and he has failed to send written objection to its contents within ten days after its receipt; or

(d) The party against whom enforcement is sought admits in his pleading, testimony or otherwise in court that a contract was made for sale of a stated quantity of described securities at a defined or stated price. (1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 4, Uniform Sales Act (which was based on Section 17 of the statute of 29 Charles II).

Purposes:

1. This Section is intended to conform the statute of frauds provisions with regard to securities to the policy of the like provisions in Article 2 (Section 2-201). The chief difference is that this Section requires that quantity and price be specified.

2. What will be sufficient specification will vary with the circumstances. Where the transaction is on an exchange or an over-the-counter market where daily quotations of the security are available "100 shares X. Corp. comm. at market" should suffice. If there is no readily available standard to interpret "at market" there is no "defined or stated price."

3. Paragraph (b) sets forth several actions which, if taken by a transferee, constitute manifestation of intent to purchase. The person receiving an initial transaction statement is given a period of 10 days to object, since there is no overt manifestation of intent. While acceptance of delivery of a certificate or instruction is seen as an overt manifestation so that there is no grace period, in practice there will often be a question as to what constitutes acceptance by an organization. Failure to object to delivery within a reasonable period will be a factor to consider. Making payment is a more definite indication of intent.

4. Paragraph (c) is particularly important in the relationship of broker (Section 8-303) and customer. Normally a great volume of such business is done over the telephone. Orders are executed almost immediately and confirmed on the same or the next business day, usually on standard forms which as to the broker more than meet the minimal requirements of paragraph (a). It is reasonable to require the customer to raise his objection, if any, within ten days after the confirmation has been received (Section 1-201).

Cross Reference:
Section 2-201.

Definitional Cross References:
"Action". Section 1-201.
"Broker". Section 8-303.
"Certificated Security". Section 8-102.
"Contract". Section 1-201.
"Delivery". Section 1-201.
"Initial Transaction Statement". Section 8-408.
"Instruction". Section 8-308.
"Issuer". Section 8-201.
"Party". Section 1-201.
"Purchase". Section 1-201.
"Reasonable Time". Section 1-204.
"Security". Section 8-102.
"Send". Section 1-201.
"Signed". Section 1-201.
"Uncertificated Security". Section 8-102.
"Writing". Section 1-201.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, deleted "or" at the end of subdivision (a); and in subdivision (b), substituted "a certificated security or transfer instruction" for "the security," inserted the language beginning "or transfer of an uncertificated security" and ending "statement confirming the registration," and deleted "or" at the end of the subdivision.

CASE NOTES

Applied in Stancil v. Stancil, 326 N.C. 766, 392 S.E.2d 373 (1990).

Cited in Forstmann v. Culp, 648 F. Supp. 1379 (M.D.N.C. 1986); Freese v. Smith, 110 N.C. App. 28, 428 S.E.2d 841 (1993).

§ 25-8-320. Transfer or pledge within a central depository system.

(1) In addition to other methods, a transfer, pledge, or release of a security or any interest therein may be effected by the making of appropriate entries on the books of a clearing corporation reducing the account of the transferor, pledgor, or pledgee and increasing the account of the transferee, pledgee, or pledgor by the amount of the obligation or the number of shares or rights transferred, pledged, or released, if the security is shown on the account of a transferor, pledgor, or pledgee on the books of the clearing corporation; is subject to the control of the clearing corporation; and

(a) If certificated,

(i) Is in the custody of the clearing corporation, another clearing corporation, a custodian bank, or a nominee of any of them; and

(ii) Is in bearer form or indorsed in blank by an appropriate person or registered in the name of the clearing corporation, a custodian bank, or a nominee of any of them; or

(b) If uncertificated, is registered in the name of the clearing corporation, another clearing corporation, a custodian bank, or a nominee of any of them.

(2) Under this section entries may be made with respect to like securities or interests therein as a part of a fungible bulk and may refer merely to a quantity of a particular security without reference to the name of the registered owner, certificate or bond number, or the like, and, in appropriate cases, may be on a net basis taking into account other transfers, pledges, or releases of the same security.

(3) A transfer under this section is effective (G.S. 25-8-313) and the purchaser acquires the rights of the transferor (G.S. 25-8-301).

A pledge or release under this section is the transfer of a limited interest. If a pledge or the creation of a security interest is intended, the security interest is perfected at the time when both value is given by the pledgee and the appropriate entries are made (G.S. 25-8-321). A transferee or pledgee under this section may be a bona fide purchaser (G.S. 25-8-302).

(4) A transfer or pledge under this section is not a registration of transfer under Part 4 of this Article.

(5) That entries made on the books of the clearing corporation as provided in subsection (1) are not appropriate does not affect the validity or effect of the entries or the liabilities or obligations of the clearing corporation to any person adversely affected thereby. (1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. Consistent with the underlying purposes and policies of this Act "to permit the continued expansion of commercial practices through custom, usage and agreement of the parties" — subsection (2)(b) of Section 1-102 — this Section expressly authorizes a newly developing and commercially useful method of transferring or pledging securities on the organized securities markets, particularly among brokers and banks but not necessarily so limited. A clearing corporation is a special kind of financial intermediary. It holds securities on deposit from brokers, banks and other financial institutions, and clears trades among its depositors by making entries on its records. This section sets forth rules for determining when such entries are effective to constitute a transfer (Section 8-313(1)(g)).

The basic requirements, outlined in subsection (1), are that the security ultimately be subject to the control of the clearing corporation making the entries and that the security be in a form that would allow the clearing corporation (or a person acting subject to its orders) to have a new security registered in the name of, and transferred to, a purchaser. The latter requirement is specified in some detail. A certificated security must be in the custody of either the clearing corporation making the entries, another clearing corporation, a custodian bank or nominee; and it must be either in bearer form, registered in the name of the clearing corporation (or of one of the clearing corporations if there are more than one involved), or else indorsed so that the clearing corporation (or one of them) could obtain registration of a transfer from the issuer. (The phrase "registered in the name of the clearing corporation" in subparagraph (1)(a)(ii) should be interpreted liberally so as to include restrictive indorsements and also to include registration or indorsement to either of the clearing corporations.) An uncertificated security must be registered in the name of a clearing corporation, a custodian bank or a nominee.

The requirement that the security be subject to the control of the clearing corporation means that if a certificated security is in the custody of, or an uncertificated security is registered in the name of, another clearing corporation or a custodian bank, the clearing corporation on whose records the entries in question are made must have the right to give orders to that person as to how and when to dispose of the security. That right may be an indirect one — for example, a security is subject to the control of Clearing Corporation A if the security is certificated and has been deposited in A's account with Clearing Corporation B, which in turn has deposited the security in its account with C, which may be either another clearing corporation or a custodian bank. Clearing Corporation A can give orders to B which in turn can give orders to C.

2. Subsection (2) makes clear that securities of the same issue may be treated as fungible interests, and that entries may be merely debits and credits to the accounts of the participants.

3. Subsection (4) makes clear that transfer, pledge or release under this Section does not affect the registration of ownership or pledge on the issuer's records.

Subsection (5) states that the entries made pursuant to this Section are effective to transfer the subject securities regardless of the fact that the entries were not appropriate. A person wronged by an inappropriate transfer may pursue his remedies against the transferee and against the clearing corporation. The nature of the rights between the clearing corporation and its participants is left to private contract and case law. See Section 8-315 as to actions against the transferee.

Cross References:
Sections 1-102(2)(b), 8-301, 8-302, 8-313, 8-315 and 8-321.

Definitional Cross References:

"Appropriate Person". Section 8-102.
"Bearer Form". Section 8-102.
"Bona Fide Purchaser". Section 8-302.
"Certificated Security". Section 8-102.
"Clearing Corporation". Section 8-102.
"Custodian Bank". Section 8-102.
"Fungible". Section 1-201.
"Indorsed". Section 8-308.
"Person". Section 1-201.
"Purchaser". Section 1-201.
"Rights". Section 1-201.
"Security". Section 8-102.
"Security Interest". Section 1-201.
"Uncertificated Security". Section 8-102.
"Value". Section 1-201.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, rewrote this section.

§ 25-8-321. Enforceability, attachment, perfection and termination of security interests.

(1) A security interest in a security is enforceable and can attach only if it is transferred to the secured party or a person designated by him pursuant to G.S. 25-8-313(1).

(2) A security interest so transferred pursuant to agreement by a transferor who has rights in the security to a transferee who has given value is a perfected security interest, but a security interest that has been transferred solely under paragraph (i) of G.S. 25-8-313(1) becomes unperfected after 21 days unless, within that time, the requirements for transfer under any other provision of G.S. 25-8-313(1) are satisfied.

(3) A security interest in a security is subject to the provisions of Article 9, but:

(a) No filing is required to perfect the security interest; and

(b) No written security agreement signed by the debtor is necessary to make the security interest enforceable, except as provided in paragraph (h), (i), or (j) of G.S. 25-8-313(1). The secured party has the rights and duties provided under G.S. 25-9-207, to the extent they are applicable, whether or not the security is certificated, and, if certificated, whether or not it is in his possession.

(4) Unless otherwise agreed, a security interest in a security is terminated by transfer to the debtor or a person designated by him pursuant to a provision of G.S. 25-8-313(1). If a security is thus transferred, the security interest, if not terminated, becomes unperfected unless the security is certificated and is delivered to the debtor for the purpose of ultimate sale or exchange or presentation, collection, renewal, or registration of transfer. In that case, the security interest becomes unperfected after 21 days unless, within that time, the security (or securities for which it has been exchanged) is transferred to the secured party or a person designated

by him pursuant to a provision of G.S. 25-8-313(1). (1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. This section is intended to govern the creation, perfection and termination of security interests in all securities, certificated and uncertificated. Subsection (1) requires an effective transfer under Section 8-313(1) as formal evidence of the security interest. The requirement that there be formal evidence of the creation of a security interest in collateral other than securities can be satisfied by having the debtor sign a security agreement or by having the secured party take possession of the collateral. Section 9-203. Transfers pursuant to paragraphs (a)—(g) of Section 8-313(1) all involve either delivery to the secured party or else some other specific event that is the functional equivalent of delivery. Transfers pursuant to paragraphs (h)—(j) do not involve any event that serves that function, but they require a security agreement signed by the debtor.

2. Subsection (2) provides that when value has been given and the debtor has rights in the collateral, an appropriate transfer will result not only in an enforcement security interest but also in one that is perfected. Under this section, an unperfected security interest in a security cannot be created. A security interest created by transfer under Section 8-313(1)(i), however, may become unperfected if, within 21 days, the requirements of another method of effective transfer are not satisfied.

3. Subsection (3) expressly makes a security interest in securities subject to the provisions of Article 9 except those provisions dealing with the creation and perfection of security interests. Those matters are governed by this section. In addition, the provisions of Section 9-207, which govern the rights and duties of the pledgee of a certificated security, are extended, to the extent they are applicable, to all secured parties, whether or not the possession of a certificated security is involved. Thus, in the absence of agreement to the contrary, the secured party, who might be the registered owner of an uncertificated security, would have the duty to remit dividends he received to the debtor or to apply them in reduction of the obligation under Section 9-207(2)(c).

4. Subsection (4) provides that a security interest is terminated by retransfer to the debtor unless the parties otherwise agree. Even when the parties agree that the security interest is to continue, it will become unperfected unless there is delivery of a certificated security for the limited purposes described in the second sentence. Compare Section 9-304(5) and (6).

Cross References:
Sections 8-312 and 9-203. See generally Article 9.

Definitional Cross References:
"Certificated Security". Section 8-102.
"Debtor". Section 9-105.
"Person". Section 1-201.
"Rights". Section 1-201.
"Secured Party". Section 9-105.
"Security". Section 8-102.
"Security Agreement". Section 9-105.
"Security Interest". Section 1-201.
"Signed". Section 1-201.
"Value". Section 1-201.

Editor's Note. — Session Laws 1989, c. 588, s. 3 made this section effective October 1, 1989.

PART 4.

REGISTRATION.

§ 25-8-401. Duty of issuer to register transfer, pledge, or release.

(1) If a certificated security in registered form is presented to the issuer with a request to register transfer, or an instruction is presented to the issuer with a request to register transfer, pledge, or release, the issuer shall register the transfer, pledge, or release as requested if:

(a) The security is indorsed or the instruction was originated by the appropriate person or persons (G.S. 25-8-308);

(b) Reasonable assurance is given that those indorsements or instructions are genuine and effective (G.S. 25-8-402);

(c) The issuer has no duty as to adverse claims or has discharged the duty (G.S. 25-8-403);

(d) Any applicable law relating to the collection of taxes has been complied with; and

(e) The transfer, pledge, or release is in fact rightful or is to a bona fide purchaser.

(2) If an issuer is under a duty to register a transfer, pledge, or release of a security, the issuer is also liable to the person presenting a certificated security or an instruction for registration or his principal for loss resulting from any unreasonable delay in registration or from failure or refusal to register the transfer, pledge, or release. (1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. Section 8-201(3) defines "issuer" as used in this Part 4 as the person on whose behalf transfer books are maintained. Transfer agents, registrars or the like have rights and duties under this Part within the scope of their respective functions, similar to those of the issuer (Section 8-406).

2. There is a substantial and heterogeneous body of case law as to the issuer's duty to register a transfer and as to his liability for improper registration, e.g., on an unauthorized signature (Section 8-311), or where the indorsement is not that of an appropriate person (Section 8-308), and generally under circumstances where the issuer is deemed to have had notice of an adverse claim (Section 8-302) and thus of the possible wrongfulness of the transfer.

In general this section and those which follow it continue the well-settled rules found in the case law as to duty to register and as to liability for improper registration on an unauthorized signature, or where the indorsement is not that of an appropriate person. They also extend the application of those rules to uncertificated securities.

In all other areas, the issuer's potential liability for wrongful registration of transfer has been substantially reduced. The rules found in the case law are drastically modified in furtherance of a considered policy to speed up the registration process by narrowing the field in which the issuer historically has first sought to assure itself that it cannot be held to be on notice of an adverse claim, and, failing that assurance, has imposed rigorous requirements of proof that there is no possible impropriety.

3. This section states the basic duty of the issuer to register transfers. It states that a duty exists, but only if certain preconditions exist. If any of the preconditions do not exist, there is no duty to register transfer. If the indorsement on a security is a forgery, there is no duty. If the instruction to transfer an uncertif-

icated security is not originated by an appropriate person, there is no duty. If there has not been compliance with applicable tax laws, there is no duty. If the security is properly indorsed but nevertheless the transfer is in fact wrongful, there is no duty unless the transfer is to a bona fide purchaser (and the other preconditions exist). Cf. Kaiser-Frazer Corp. v. Otis & Co., 195 F.2d 838 (2d Cir. 1952), cert. denied, 73 S.Ct. 89, 344 U.S. 856, 97 L.Ed. 664.

This section does not constitute a mandate that all preconditions must be met before the issuer registers a transfer. If it so desires, the issuer can waive the reasonable assurances specified in paragraph (b). If it has confidence in the responsibility of the persons requesting transfer, it can ignore questions of compliance with tax laws. If it has no duty to inquire into or otherwise recognize adverse claims, it can and it should register transfer without inquiry as to the rightfulness of a transfer.

Sections 8-402 and 8-403 are the sections dealing with the specific rules as to assurances and duty to inquire.

4. By subsection (2) the person entitled to registration may not only compel it but may hold the issuer liable in damages for unreasonable delay.

5. See Section 8-404 as to the issuer's liability for wrongful registration of transfer.

Cross References:

Point 1: Sections 8-201(3) and 8-406.

Point 2: Sections 8-204, 8-301, 8-308 and 8-311.

Definitional Cross References:

"Adverse Claim". Section 8-302.
"Appropriate Person". Section 8-308.
"Bona Fide Purchaser". Section 8-302.
"Certificated Security". Section 8-102.
"Genuine". Section 1-201.
"Indorsement". Section 8-308.
"Instruction". Section 8-308.
"Issuer". Section 8-201.
"Person". Section 1-201.
"Registered Form". Section 8-102.
"Security". Section 8-102.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, added "pledge, or release" in the catchline, and rewrote this section.

§ 25-8-402. Assurance that indorsements and instructions are effective.

(1) The issuer may require the following assurance that each necessary indorsement of a certificated security or each instruction (G.S. 25-8-308) is genuine and effective:

(a) In all cases, a guarantee of the signature (G.S. 25-8-312(1) or (2)) of the person indorsing a certificated security or originating an instruction including, in the case of an instruction, a warranty of the taxpayer identification number or, in the absence thereof, other reasonable assurance of identity;

(b) If the indorsement is made or the instruction is originated by an agent, appropriate assurance of authority to sign;

(c) If the indorsement is made or the instruction is originated by a fiduciary, appropriate evidence of appointment or incumbency;

(d) If there is more than one fiduciary, reasonable assurance that all who are required to sign have done so; and

(e) If the indorsement is made or the instruction is originated by a person not covered by any of the foregoing, assurance appropriate to the case corresponding as nearly as may be to the foregoing.

(2) A "guarantee of the signature" in subsection (1) means a guarantee signed by or on behalf of a person reasonably believed by the issuer to be responsible. The issuer may adopt standards with respect to responsibility if they are not manifestly unreasonable.

(3) "Appropriate evidence of appointment or incumbency" in subsection (1) means:

(a) In the case of a fiduciary appointed or qualified by a court, a certificate issued by or under the direction or supervision of that court or an officer thereof and dated within 60 days before the date of presentation for transfer, pledge, or release; or

(b) In any other case, a copy of a document showing the appointment or a certificate issued by or on behalf of a person reasonably believed by the issuer to be responsible or, in the absence of that document or certificate, other evidence reasonably deemed by the issuer to be appropriate. The issuer may adopt standards with respect to the evidence if they are not manifestly unreasonable. The issuer is not charged with notice of the contents of any document obtained pursuant to this paragraph except to the extent that the contents relate directly to the appointment or incumbency.

(4) The issuer may elect to require reasonable assurance beyond that specified in this section, but if it does so and, for a purpose other than that specified in subsection (3)(b), both requires and obtains a copy of a will, trust, indenture, articles of co-partnership, bylaws, or other controlling instrument, it is charged with notice of all matters contained therein affecting the transfer, pledge, or release. (1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. As is noted in the Comment to Section 8-401, the issuer is absolutely liable for wrongful registration of transfer when the signature of the indorser is unauthorized or is not that of an appropriate person or when an instruction is not originated by an appropriate person. The issuer is entitled to require such assurance as is reasonable under the circumstances that all necessary indorsements are effective, and thus to minimize its risk. This section establishes the requirements the issuer may make in terms of documentation which, except in the rarest of instances, should be easily furnished. If a demand for further assurance is reasonable under the circumstances, subsection (4) applies.

2. Under subsection (1)(a) the issuer may require in all cases a guarantee of signature (Section 8-312). When an instruction is presented the issuer always may require either a warranty of taxpayer identification number or some other reasonable assurance as to the identity of the originator. Subsection (2) allows the issuer to require that the person making these guarantees be one reasonably believed to be responsible, and the issuer may adopt standards of responsibility which are not manifestly unreasonable. In this aspect this section approves the practice of the organized securities markets.

3. This section, by paragraphs (b) through (e) of subsection (1), permits the issuer to seek confirmation of the effectiveness of the indorsement or instruction. The permitted methods act as a double check on matters which are within the warranties of the guarantor of signature. See Section 8-312. In addition, to some extent they act also as a check on the right to transfer (i. e. to deliver the indorsed certificated security or to transmit an instruction). Thus, an agent may be required to submit his power of attorney, a corporation to submit a certified resolution evidencing the authority of its signing officer to sign, an executor or administrator to submit the usual "short-form certificate", etc. But failure of a fiduciary to obtain court approval of the transfer or to comply with other requirements does not make his signature unauthorized. Section 8-308(11). Hence court orders and other

controlling instruments are omitted from subsection (1).

Subsection (1)(c) authorizes the issuer to require "appropriate evidence" of appointment or incumbency, and subsection (3) indicates what evidence will be "appropriate". In the case of a fiduciary appointed or qualified by a court that evidence will be a court certificate dated within sixty days before the date of presentation. Where the fiduciary is not appointed or qualified by a court, as in the case of a successor trustee, subsection (3)(b) applies. Compare Section 4 of the Uniform Act for Simplification of Fiduciary Security Transfers. If the security is registered in the name of the fiduciary, the issuer may under Section 8-403(3)(a) assume without inquiry that the fiduciary status continues until written notice to the contrary is received. Hence no evidence of appointment or incumbency is needed unless such a notice has been received. Compare Section 2 of the Uniform Act for Simplification of Fiduciary Security Transfers.

Where subsection (3)(b) applies, the issuer may require a copy of a trust instrument or other document showing the appointment, or it may require the certificate of a responsible person. In the absence of such a document or certificate, it may require other appropriate evidence. If a document is obtained solely as "appropriate evidence of appointment or incumbency" under subsection (3)(b), the issuer is not charged with notice of its contents except to the extent that the contents relate directly to the appointment or incumbency. But if the document is obtained for any other purpose, the issuer may be charged under subsection (4). See Point 6 below.

4. There are many other types of situations where, under the case law, the issuer would be deemed to have notice of possible adverse claims, and therefore would register transfer at its peril. Typical are: knowledge that the registered owner is dead, the fact that he is described or identifiable as a fiduciary, etc. Perhaps the most ubiquitous is where a will, trust indenture or other controlling instrument is on file with the issuer or transfer agent for some other purpose (e.g., in the banking as distinct from the corporate agency department of a trust company), but, unless specifically asked for, would not come to the attention of the officers responsible for the registration of security transfers. Here, under the cases, there is an area of liability based upon notice of possible adverse claims affecting the right to deliver the security, an area to which the warranties of the guarantor of signature specifically do not extend. See Section 8-312(4). Also, it is the area in which in the past issuers and their agents, fearing possible lawsuits based upon unauthorized transfers by fiduciaries and the like, have made it a practice to demand complete and convincing evidence that the transfer is proper in all of its aspects. Sections 8-403 and 8-404 strictly circumscribe the issuer's liability in such cases, and this section therefore makes no provisions for assurances to cover them.

5. Circumstances may indicate that a necessary signature was unauthorized or was not that of an appropriate person. Such circumstances would be ignored at risk of absolute liability, and to minimize that risk the issuer may properly exercise the option given by subsection (4) to require assurance beyond that specified in subsection (1). On the other hand, the facts at hand may reflect only on the rightfulness of the transfer. Such facts do not operate, as they did under prior law, automatically to create a duty of inquiry, unless there is timely notification of the existence of an adverse claim. See Section 8-403(1) and (4). If there is a duty of inquiry under Section 8-403, the issuer may follow the procedure provided in Section 8-403(2) or (5), or it may discharge the duty of inquiry as to a certificated security "by any reasonable means". The same is true if the issuer's overriding duty to conduct its functions in good faith (Section 1-203) comes into play — e.g., where the certificated security is indorsed or the instruction is originated by a person known to the employee handling the transaction for the issuer to be wanted by the police.

6. Specifically to implement the policy of this Act to discourage issuers from requiring excessive documentation, subsection (4) provides that if the issuer elects to require additional documentation for any purpose other than to obtain "appropriate evidence of appointment or incumbency" under subsection (3)(b) and both requires and obtains a copy of a will, trust, indenture, articles of co-partnership, by-laws or other controlling instrument, it is charged with notice of all matters contained therein affecting the transfer. It follows that an instrument voluntarily submitted, without having been "required" by the issuer, may be returned without examination.

But if the issuer has no duty to inquire and demands more than reasonable assurance that the instruction or the necessary indorsements are genuine and effective, the presenter of the instruction or the certificated security may refuse the demand and sue for improper refusal to register. Section 8-401.

Cross References:

Point 1: Sections 8-308 and 8-311.
Point 2: Section 8-312.
Point 3: Sections 8-308 and 8-312.
Point 4: Sections 8-312, 8-403 and 8-404.
Point 5: Sections 1-203 and 8-403.
Point 6: Section 8-401.

Definitional Cross References:

"Adverse Claim". Section 8-302.
"Certificated Security". Section 8-102.
"Genuine". Section 1-201.
"Indorsement". Section 8-308.
"Instruction". Section 8-308.
"Issuer". Section 8-201.
"Notice". Section 1-201.
"Person". Section 1-201.
"Signed". Section 1-201.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, inserted "and instructions" in the catchline, and rewrote this section.

§ 25-8-403. Issuer's duty as to adverse claims.

(1) An issuer to whom a certificated security is presented for registration is under a duty to inquire into adverse claims if

(a) A written notification of an adverse claim is received at a time and in a manner which affords the issuer a reasonable opportunity to act on it prior to the issuance of a new, reissued or re-registered certificated security and the notification identifies the claimant, the registered owner and the issue of which the security is a part and provides an address for communications directed to the claimant; or

(b) The issuer is charged with notice of an adverse claim from a controlling instrument which it has elected to require under G.S. 25-8-402(4).

(2) The issuer may discharge any duty of inquiry by any reasonable means, including notifying an adverse claimant by registered or certified mail at the address furnished by him or if there be no such address at his residence or regular place of business that the certificated security has been presented for registration of transfer by a named person, and that the transfer will be registered unless within thirty days from the date of mailing the notification, either

(a) An appropriate restraining order, injunction or other process issues from a court of competent jurisdiction; or

(b) There is filed with the issuer an indemnity bond sufficient in the issuer's judgment to protect the issuer and any transfer agent, registrar or other agent of the issuer involved, from any loss which it or they may suffer by complying with the adverse claim.

(3) Unless an issuer is charged with notice of an adverse claim from a controlling instrument which it has elected to require under G.S. 25-8-402(4) or receives notification of an adverse claim under subsection (1) of this section, if a certificated security presented for registration is indorsed by the appropriate person or persons the issuer is under no duty to inquire into adverse claims. In particular

(a) An issuer registering a security in the name of a person who is a fiduciary or who is described as a fiduciary is not bound to inquire into the existence, extent, or correct description of the fiduciary relationship and thereafter the issuer may assume without inquiry that the newly registered owner continues to be the fiduciary until the issuer receives written notice that the fiduciary is no longer acting as such with respect to the particular security;

(b) An issuer registering transfer on an indorsement by a fiduciary is not bound to inquire whether the transfer is made in compliance with a controlling instrument or with the law of the state having jurisdiction of the fiduciary relationship, including any law requiring the fiduciary to obtain court approval of the transfer; and

(c) The issuer is not charged with notice of the contents of any court record or file or other recorded or unrecorded document even though the document is in its possession and even though the transfer is made on the indorsement of a fiduciary to the fiduciary himself or to his nominee.

(4) An issuer is under no duty as to adverse claims with respect to an uncertificated security except:

(a) Claims embodied in a restraining order, injunction, or other legal process served upon the issuer if the process was served at a time and in a manner affording the issuer a reasonable opportunity to act on it in accordance with the requirements of subsection (5);

(b) Claims of which the issuer has received a written notification from the registered owner or the registered pledgee if the notification was received at a time and in a manner affording the issuer a reasonable opportunity to act on it in accordance with the requirements of subsection (5);

(c) Claims (including restrictions on transfer not imposed by the issuer) to which the registration of transfer to the present registered owner was subject and were so noted in the initial transaction statement sent to him; and

(d) Claims as to which an issuer is charged with notice from a controlling instrument it has elected to require under G.S. 25-8-402(4).

(5) If the issuer of an uncertificated security is under a duty as to an adverse claim, he discharges that duty by:

(a) Including a notation of the claim in any statements sent with respect to the security under G.S. 25-8-408(3), (6), and (7); and

(b) Refusing to register the transfer or pledge of the security unless the nature of the claim does not preclude transfer or pledge subject thereto.

(6) If the transfer or pledge of the security is registered subject to an adverse claim, a notation of the claim must be included in the initial transaction statement and all subsequent statements sent to the transferee and pledgee under G.S. 25-8-408.

(7) Notwithstanding subsections (4) and (5), if an uncertificated security was subject to a registered pledge at the time the issuer first came under a duty as to a particular adverse claim, the issuer has no duty as to that claim if transfer of the security is requested by the registered pledgee or an appropriate person acting for the registered pledgee unless:

(a) The claim was embodied in legal process which expressly provides otherwise;

(b) The claim was asserted in a written notification from the registered pledgee;

(c) The claim was one as to which the issuer was charged with notice from a controlling instrument it required under G.S. 25-8-402(4) in connection with the pledgee's request for transfer; or

(d) The transfer requested is to the registered owner. (1965, c. 700, s. 1; 1977, c. 814, s. 9; 1989, c. 588, s. 1; 1989 (Reg. Sess., 1990), c. 1024, s. 9(d).)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 3, Uniform Fiduciaries Act.

Purposes:

1. In consonance with the general policy of this Part 4 (See the Comments to Sections 8-401 and 8-402), and subject always to the overriding duty of good faith in the performance of its functions (Section 1-203) this section limits the issuer's duty as to adverse claims to the specific situations stated in subsections (1) as to certificated securities and (4) as to uncertificated securities.

Paragraph (a) of subsection (1) is the ordinary "stop transfer" notice commonly resorted to by the owner of a lost or stolen certificated security or in a situation where breach of trust, disregard of a valid restriction on transfer, or other improper action is feared to have occurred or to be about to occur.

Notification under paragraph (a) of subsection (1) must be "written" (Section 1-201(46)) and must be "received" (Section 1-201(26)) "at a time and in a manner which affords the issuer a reasonable opportunity to act on it prior to the issuance of a new, reissued or re-registered security." Cf. Section 1-201(27). Its contents must be such as to make reasonably clear who makes the claim and with respect to what security, and where communications may be addressed to him. Compare Section 5(a) of the Uniform Act for Simplification of Fiduciary Security Transfers.

A notification once so received is easily keyed to the appropriate records. Therefore, no defense of "forgotten notice", possibly relevant on the issue of bona fide purchase as to bearer form securities, is available under this section.

As to paragraph (b) see the Comment to Section 8-402.

2. With respect to certificated securities subsection (2) does not limit the issuer to any specific method of discharging a duty of inquiry. It may use "any reasonable means" including the procedure spelled out in the subsection. That procedure, based on a New York statute respecting adverse claims to bank deposits and on commercial practice, should be effective in the large majority of cases to protect the rights of all interested parties and relieve the issuer of further responsibility. No delay during the thirty day period will be "unreasonable" under Section 8-401(2).

3. Subsection (3) is the converse of subsection (1) and spells out some specific situations in which under prior law a duty to inquire existed or may have existed. Compare Sections 2 and 3 of the Uniform Act for Simplification of Fiduciary Security Transfers. As to the effect of subsection (3)(a) on the effectiveness of an indorsement, see the Comment to Section 8-404.

4. Transfer of uncertificated securities does not take place until registration, so that any mandated delay seriously impairs an owner's ability to sell or pledge his security. Since a prudent purchaser may not pay unless he receives a clean initial transaction statement, the effect of a rule giving the issuer a duty to inquire any time it received any written notice of an adverse claim, however frivolous, would be disastrous. Because of this important difference between certificated and uncertificated securities, there are separate provisions as to duty to inquire. Subsections (4), (5), (6) and (7) apply only to uncertificated securities, and are intended to accommodate the interests of owners, purchasers, issuers and adverse claimants.

Subsection (4) states that an issuer has no duty as to adverse claims except in four described situations. Mere written notifications result in a duty only when they come from existing owners and pledgees and are analogous to stop payment orders on checks. There is a duty as to claims to which the security was subject when it was purchased by the present owner, a situation with which the owner is already familiar. There is a duty as to claims arising from the issuer's request for documentation under Section 8-402.

The significant difference of subsection (4) from subsection (1) is that claims asserted by third parties, in order to impose a duty on the issuer, must be supported by legal process. This will constitute assurance that the claim is not merely frivolous and that its assertion is more than harassment. In most cases the owner will have been notified and have had the opportunity to be heard. While claims thus asserted may ultimately be adjudged invalid, the owner will not be tied up by a bare written communication from the claimant. On the other hand, while a more substantial burden is imposed on the claimant, there is a channel through which he can assert his claim before the rights of a bona fide purchaser intervene.

If the claimant sues the owner in a court that has no jurisdiction over the issuer and an injunction is issued against the owner forbidding him to transfer the security, the issuer has a duty under paragraph (4)(a) if it receives an authenticated copy of the order. Even though in that situation the order is not directed to the issuer, it is "legal process served upon the issuer" for purposes of paragraph (4)(a). There is sufficient guarantee that the complaint is not frivolous. Further, the issuer might breach its duty to act in good faith if it registered a transfer in spite of such clear evidence of impropriety.

5. Once it is established that the claim imposes a duty on the issuer, notations of the claim must be contained in all statements sent with respect to the security, and registration of transfer or pledge must be refused unless the nature of the claim is consistent with transfer or pledge subject to the claim. When transfer or pledge is registered subject to the claim, subsection (6) requires that the claim be noted in all statements sent to the transferee or pledgee.

Subsection (7) deals with the situation in which an uncertificated security is already subject to a registered pledge when the issuer first learns of an adverse claim as to which it has a duty. In that event, the registered pledgee who became such without notice of the claim may be a bona fide purchaser with the right to transfer the security free of the claim. That right cannot be curtailed by the claim of a third party (including the registered owner) unless legal process embodying the claim expressly deals with the pledgee's interest. There is obviously no curtailment of the pledgee's right when the claim is asserted by the pledgee himself. It should be curtailed if the pledgee's right to obtain registration of transfer is called into question by a controlling instrument which the issuer elects to require before acting on the pledgee's request. Since the transfer to the registered owner is the equivalent of a release of the pledge, such a transfer does not terminate the issuer's duty as to the claim.

Cross References:

Sections 1-203, 8-304, 8-401, 8-402, 8-404, 8-405 and 8-408.

Definitional Cross References:

"Adverse Claim". Section 8-302.
"Appropriate Person". Section 8-308.
"Certificated Security". Section 8-102.
"Indorsement". Section 8-308.
"Initial Transaction Statement". Section 8-408.
"Issuer". Section 8-201.
"Notice". Section 1-201.
"Notification". Section 1-201.
"Person". Section 1-201.
"Security". Section 8-102.
"Uncertificated Security". Section 8-102.
"Written". Section 1-201.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, substituted the present catchline for "Limited duty of inquiry"; inserted "certificated" in the introductory language of subsection (1), in subdivision (1)(a), and in the introductory language of subsection (2); substituted "G.S. 25-8-402(4)" for "subsection (4) of G.S. 25-8-402" in subdivision (1)(b) and in the introductory language of subsection (3); in subdivision (2)(b), added "There is filed with the issuer," and deleted "is filed with the issuer" following "claim"; substituted "if a certificated security" for "where a security" in the introductory language of subsection (3); deleted former subsection (4) relating to this section and Article 8 not being construed to repeal the provisions of Article 2 of Chapter 32 and relating to Article 8 controlling over any inconsistencies between Article 2 of Chapter 32 and Article 8; and added the present subsections (4) through (7).

The 1989 (Reg. Sess., 1990) amendment, effective July 27, 1990, substituted "G.S. 25-8-408" for "G.S. 25-8-4" in subdivision (6).

§ 25-8-404. Liability and nonliability for registration.

(1) Except as otherwise provided in any law relating to the collection of taxes, the issuer is not liable to the owner, pledgee, or any other person suffering loss as a result of the registration of a transfer, pledge, or release of a security if

(a) There were on or with a certificated security the necessary indorsements or the issuer has received an instruction originated by an appropriate person (G.S. 25-8-308); and

(b) The issuer had no duty to inquire into adverse claims or has discharged the duty (G.S. 25-8-403).

(2) If an issuer has registered a transfer of a certificated security to a person not entitled to it the issuer on demand shall deliver a like security to the true owner unless

(a) The registration was pursuant to subsection (1);

(b) The owner is precluded from asserting any claim for registering the transfer under G.S. 25-8-405(1); or

(c) The delivery would result in overissue, in which case the issuer's liability is governed by G.S. 25-8-104.

(3) If an issuer has improperly registered a transfer, pledge, or release of an uncertificated security, the issuer on demand from the injured party shall restore the records as to the injured party to the condition that would have obtained if the improper registration had not been made unless

(a) The registration was pursuant to subsection (1); or

(b) The registration would result in overissue, in which case the issuer's liability is governed by G.S. 25-8-104. (1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. This section states the basic exonerative policy of this Article where there is no duty to inquire into adverse claims and the certificated security is appropriately indorsed or the issuer receives an instruction from an appropriate person.

Note that under subsection (1)(a) exoneration depends on whether or not the necessary indorsements were in fact on or with the security. The issuer cannot, for example, defend a suit based on its having registered a transfer on a forged indorsement on the ground that it received the assurances listed in Section 8-402 and was under no duty to go further. It has that option under Section 8-402(4).

Note, however, that this Act excludes from the category of "unauthorized indorsement" (Section 8-311) certain situations that might have been included in that category under prior law — e.g., where there has been a change of circumstances subsequent to the signature (subsection (10) of Section 8-308), and where the signature is that of a fiduciary who has failed to obtain court approval of the transfer (subsection (11) of Section 8-308). Similarly, when an issuer acts on the assumption permitted by subsection (3)(a) of Section 8-403, that a fiduciary registered owner continues to act as such, the "necessary indorsement" under subsection (1)(a) of this section is that of the registered owner under Section 8-308(8)(a), even though a successor has in fact been appointed. In these and other cases, where the question is one affecting only the rightfulness of the transfer, the issuer need only establish that it had no duty under Section 8-403 to inquire into adverse claims or that it has discharged any such duty.

2. The registered owner's right to receive a new security where the issuer has wrongfully registered a transfer is established, but the cases have also recognized his right to elect between an equitable action to compel issue of a new security and an action for damages. Cf. Casper v. Kalt-Zimmers Mfg. Co., 159 Wis. 517, 149 N.W. 754 (1914). Such election of remedies is no longer available. The true owner of a certificated security is now required to take a new security except where an overissue would result and a similar security is not reasonably available for purchase. See Section 8-104. The true owner of an uncertificated security is entitled and required to take restoration of the records to their proper state, with a similar exception for overissue.

Nothing in subsections (2) and (3) is intended to deny the owner the right to choose the form of his security whenever the issuer maintains securities of the same issue in both certificated and uncertificated form (Section 8-407).

Cross References:

Point 1: Sections 8-308, 8-402 and 8-403.

Point 2: Sections 8-104, 8-405 and 8-407.

Definitional Cross References:

"Adverse Claim". Section 8-302.
"Appropriate Person". Section 8-308.
"Certificated Security". Section 8-102.
"Delivery". Section 1-201.
"Indorsement". Section 8-308.
"Instruction". Section 8-308.
"Issuer". Section 8-201.
"Overissue". Section 8-104.
"Party". Section 1-201.
"Person". Section 1-201.
"Security". Section 8-102.
"Uncertificated Security". Section 8-102.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, in subsection (1), in the introductory language, inserted "owner, pledgee" and "pledge, or release," in subdivision (a), substituted "a certificated security" for "the security," and "or the issuer has received an instruction originated by an appropriate person (G.S. 25-8-308); and" for "(G.S. 25-8-308); and," and "the duty" for "any such duty" in subdivision (b); in subsection (2), in the introductory language, substituted "If an issuer" for "Where an issuer," inserted "certificated," and substituted "shall deliver" for "must deliver," deleted "or" at the end of subdivision (a), substituted "G.S. 25-8-405(1)" for "subsection (1) of the following section [G.S. 25-8-405]" in subdivision (b), and substituted "The delivery" for "Such delivery" in subdivision (c); and added subsection (3).

§ 25-8-405. Lost, destroyed and stolen certificated securities.

(1) If a certificated security has been lost, apparently destroyed or wrongfully taken and the owner fails to notify the issuer of that fact within a reasonable time after he has notice of it and the issuer registers a transfer of the security before receiving such a notification, the owner is precluded from asserting against the issuer any claim for registering the transfer under G.S. 25-8-404 or any claim to a new security under this section.

(2) If the owner of a certificated security claims that the security has been lost, destroyed or wrongfully taken, the issuer shall issue a new certificated security or, at the option of the issuer, an equivalent uncertificated security in place of the original security if the owner

(a) So requests before the issuer has notice that the security has been acquired by a bona fide purchaser; and
(b) Files with the issuer a sufficient indemnity bond; and

(c) Satisfies any other reasonable requirements imposed by the issuer.

(3) If, after the issue of a new certificated or uncertificated security, a bona fide purchaser of the original certificated security presents it for registration of transfer, the issuer shall register the transfer unless registration would result in overissue, in which event the issuer's liability is governed by G.S. 25-8-104. In addition to any rights on the indemnity bond, the issuer may recover the new certificated security from the person to whom it was issued or any person taking under him except a bona fide purchaser or may cancel the uncertificated security unless a bona fide purchaser or any person taking under a bona fide purchaser is then the registered owner or registered pledgee thereof. (1941, c. 353, s. 20; G.S., s. 55-100; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 17, Uniform Stock Transfer Act.

Purposes:

1. By failing to notify the issuer within a reasonable time after he knows or has reason to know of the loss or theft of his certificated security, the owner is estopped from asserting the ineffectiveness of a forged or unauthorized indorsement and the wrongfulness of the registration of the transfer. Compare Section 8-311. If the lost security was indorsed by the owner, then the registration of the transfer was not wrongful under Section 8-404 unless notice had been given to the issuer.

2. The long-standing corporate practice of voluntarily issuing new certificated securities to replace lost, destroyed or stolen ones is now incorporated into law. Where reasonable requirements are satisfied and a sufficient indemnity bond supplied, a court order is no longer necessary but, of course, the court may compel a recalcitrant issuer to take action.

Subsection (2) gives the issuer the alternative of issuing an uncertificated security rather than a new certificated security. This alternative will exist only when the particular issue is partly certificated and partly uncertificated; and as a practical matter the ultimate choice will belong to the owner (Section 8-407). Compare Section 8-104 and its Comment.

3. Where an "original" certificated security has reached the hands of a bona fide purchaser, the registered owner — who was in the best position to prevent the loss, destruction or theft of his security — is now deprived of the new security issued to him as a replacement. If the security is certificated, the issuer has a right to recover it; and if the security is uncertificated, the issuer may simply cancel the registration. This changes the prior law under which the original security was ineffective after the issue of a replacement except insofar as it might represent an action for damages in the hands of a bona fide purchaser. Keller v. Eureka Brick Mach. Mfg. Co., 43 Mo.App. 84, 11 L.R.A. 472 (1890). Where both the original and the new security have reached bona fide purchasers the issuer is now required to honor both securities unless an overissue would result and the security is not reasonably available for purchase. See Section 8-104. In the latter case alone, the bona fide purchaser of the original security is relegated to an action for damages. In either case, the issuer itself may recover on the indemnity bond.

Cross References:

Sections 8-104, 8-311, 8-312, 8-402, 8-403, 8-404 and 8-407.

Definitional Cross References:

"Bona Fide Purchaser". Section 8-302.
"Certificated Security". Section 8-102.
"Issuer". Section 8-201.
"Notice". Section 1-201.
"Notify". Section 1-201.
"Overissue". Section 8-104.
"Person". Section 1-201.
"Reasonable Time". Section 1-204.
"Rights". Section 1-201.
"Security". Section 8-102.
"Uncertificated Security". Section 8-102.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, inserted "certificated" in the catchline; in subsection (1), substituted "If a certificated security" for "Where a security," and deleted "the preceding section" preceding "G.S. 25-8-404"; in the introductory language of subsection (2), substituted "If the owner" for "Where the owner," inserted "certificated" in two places, substituted "shall issue" for "must issue," and inserted "or, at the option of the issuer, an equivalent uncertificated security"; and in subsection (3), inserted "certificated" in the first and second sentences, in the first sentence, substituted "a new certificated or uncertificated security" for "the new security," and substituted "shall register" for "must register," and added the language beginning "or may cancel the uncertificated security" in the second sentence.

§ 25-8-406. Duty of authenticating trustee, transfer agent or registrar.

(1) If a person acts as authenticating trustee, transfer agent, registrar, or other agent for an issuer in the registration of transfers of its certificated securities or in the registration of transfers, pledges, and releases of its uncertificated securities, in the issue of new securities or in the cancellation of surrendered securities

(a) He is under a duty to the issuer to exercise good faith and due diligence in performing his functions; and

(b) With regard to the particular functions he performs, he has the same obligation to the holder or owner of a certificated security or to the owner or pledgee of an uncertificated security and has the same rights and privileges as the issuer has in regard to those functions.

(2) Notice to an authenticating trustee, transfer agent, registrar or other such agent is notice to the issuer with respect to the functions performed by the agent. (1965, c. 700, s. 1; 1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. Transfer agents, registrars and the like are here expressly held liable to both the issuer and the owner for wrongful refusal to register a transfer as well as wrongful registration of a transfer in any case within the scope of their respective functions where the issuer would itself be liable. Those cases which have regarded these parties solely as agents of the issuer and have therefore refused to recognize their liability to the owner for mere non-feasance, i. e., refusal to register a transfer, are now rejected. Hulse v. Consolidated Quicksilver Mining Corp., 65 Idaho 768, 154 P.2d 149 (1944); Nicholson v. Morgan, 119 Misc. 309, 196 N.Y.Supp. 147 (1922); Lewis v. Hargadine-McKittrick Dry Goods Co., 305 Mo. 396, 274 S.W. 1041 (1924).

2. The practice frequently followed by authenticating trustees of issuing certificates of indebtedness rather than authenticating duplicate certificates where securities have been lost or stolen now becomes obsolete in view of the provisions of the preceding section of this Article, which makes express provision for the issue of substitute securities. It can no longer be considered a breach of trust or lack of due diligence for trustees to authenticate new securities (or initial transaction statements). Cf. Switzerland General Ins. Co. v. N.Y.C. & H.R.R. Co., 152 App.Div. 70, 136 N.Y.S. 726 (1912).

3. "Good faith and due diligence" require the use of reasonable care and the observance of "reasonable" commercial standards, and preclude arbitrary, capricious, over-cautious and super-technical objections and requirements. See Powers v. Universal Film Mfg. Co., 162 App.Div. 806, 148 N.Y.S. 114 (1914). Compliance with the provisions of this Article as to the documents which an is-

suer may properly require before registering a transfer in cases where there has been no notice of adverse claims (Section 8-402) constitutes due diligence on the part of these agents, and by insisting upon more they could incur liability for wrongful refusal to register a transfer.

Cross References:

Point 3: Sections 8-401, 8-402, 8-403 and 8-404. See Sections 1-201, 8-207, 8-208, 8-312, 8-401, 8-402, 8-403, 8-405, 8-407 and 8-408.

Definitional Cross References:

"Certificated Security". Section 8-102.
"Good Faith". Section 1-201.
"Holder". Section 1-201.
"Issuer". Section 8-201.
"Notice". Section 1-201.
"Person". Section 1-201.
"Security". Section 8-102.
"Uncertificated Security". Section 8-102.

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, in subsection (1), in the introductory language, substituted "If a person acts" for "Where a person acts," inserted "certificated," and inserted "registration of transfers, pledges, and releases of its uncertificated securities, in the," and in subdivision (1)(b), deleted "He has" preceding "With regard," inserted "he has" preceding "the same obligation," substituted "a certificated security" for "the security," and inserted "or to the owner or pledgee of an uncertificated security."

§ 25-8-407. Exchangeability of securities.

(1) No issuer is subject to the requirements of this section unless it regularly maintains a system for issuing the class of securities involved under which both certificated and uncertificated securities are regularly issued to the category of owners, which includes the person in whose name the new security is to be registered.

(2) Upon surrender of a certificated security with all necessary indorsements and presentation of a written request by the person surrendering the security, the issuer, if he has no duty as to adverse claims or has discharged the duty (G.S. 25-8-403), shall issue to the person or a person designated by him an equivalent uncertificated security subject to all liens, restrictions, and claims that were noted on the certificated security.

(3) Upon receipt of a transfer instruction originated by an appropriate person who so requests, the issuer of an uncertificated security shall cancel the uncertificated security and issue an equivalent certificated security on which must be noted conspicuously any liens and restrictions of the issuer and any adverse claims (as to which the issuer has a duty under G.S. 25-8-403(4)) to which the uncertificated security was subject. The certificated security shall be registered in the name of and delivered to:

(a) The registered owner, if the uncertificated security was not subject to a registered pledge; or
(b) The registered pledgee, if the uncertificated security was subject to a registered pledge. (1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

This section deals with the right of the holder of a certificated security to exchange it for an equivalent uncertificated security and the right of the registered owner or registered pledgee of an uncertificated security to obtain a certificated security in exchange for it. This section is applicable only in those situations where both certificated and uncertificated securities exist within the same issue and either form is available to the particular owner. Subsection (1) so limits its applicability.

Neither this nor any other section of this Article is intended to mandate the establishment or continuance of a dual system of registration. It is contemplated that some issuers may provide for both forms of securities on a more or less indefinite basis. Issuers of existing issues which are necessarily wholly certificated may make uncertificated securities available with the intention to phase out the certificated securities over a period of time. Some issuers, if permitted by relevant law, may restrict the availability of uncertificated securities to particular categories of owners, e.g., brokers, banks and institutions.

Subsection (2) provides the mechanism for the holder of a certificated security to surrender it to the issuer and have an equivalent uncertificated security issued in exchange. Subsection (3) provides an analogous mechanism for the registered owner of an unencumbered uncertificated security or the registered pledgee of an otherwise unencumbered uncertificated security to obtain equivalent certificated securities from the issuer. Since Section 8-403 treats adverse claims with respect to certificated securities differently from adverse claims with respect to uncertificated securities, subsection (2) requires the issuer to honor the request only if it has no duty as to adverse claims. If it honored the request despite the presence of such a duty, the adverse claimant's right to block transfer might be modified. For example, if the issuer of a certificated security had received written notice from the claimant, it would be under a duty to inquire and to delay registration of transfer pending the results of the inquiry. However, if it issued an uncertificated security in place of the certificate, then it would no longer be under a duty (Section 8-403(4)(b)) and would register transfer to a bona fide purchaser without including any notation of the claim (Section 8-403(5)).

On the other hand, if the issuer is under a duty as to adverse claims with respect to an uncertificated security it will also be under a similar duty with respect to a certificated security issued to represent the same interest. Compare subsections (1) and (4) of Section 8-403. Potential purchasers will be unable to purchase free of the claim, since they will be given notice through notation on the certificate. See Sections 8-304, 8-202 and 1-201(25).

Cross References:
Sections 8-104, 8-403 and 8-405.

Definitional Cross References:
"Adverse Claim". Section 8-302.
"Appropriate Person". Section 8-308.
"Certificated Security". Section 8-102.
"Conspicuous". Section 1-201.
"Delivery". Section 1-201.
"Indorsement". Section 8-308.
"Instruction". Section 8-308.
"Issuer". Section 8-201.
"Person". Section 1-201.
"Security". Section 8-102.
"Uncertificated Security". Section 8-102.
"Written". Section 1-201.

Editor's Note. — Session Laws 1989, c. 588, s. 3 made this section effective October 1, 1989.

A former § 25-8-407 was repealed by Session Laws 1969, c. 1115, s. 1, effective at midnight, June 30, 1969.

§ 25-8-408. Statements of uncertificated securities.

(1) Within two business days after the transfer of an uncertificated security has been registered, the issuer shall send to the new registered owner and, if the security has been transferred subject to a registered pledge, to the registered pledgee a written statement containing:

(a) A description of the issue of which the uncertificated security is a part;
(b) The number of shares or units transferred;
(c) The name and address and any taxpayer identification number of the new registered owner and, if the security

has been transferred subject to a registered pledge, the name and address and any taxpayer identification number of the registered pledgee;

(d) A notation of any liens and restrictions of the issuer and any adverse claims (as to which the issuer has a duty under G.S. 25-8-403(4)) to which the uncertificated security is or may be subject at the time of registration or a statement that there are none of those liens, restrictions, or adverse claims; and

(e) The date the transfer was registered.

(2) Within two business days after the pledge of an uncertificated security has been registered, the issuer shall send to the registered owner and the registered pledgee a written statement containing:

(a) A description of the issue of which the uncertificated security is a part;

(b) The number of shares or units pledged;

(c) The name and address and any taxpayer identification number of the registered owner and the registered pledgee;

(d) A notation of any liens and restrictions of the issuer and any adverse claims (as to which the issuer has duty under G.S. 25-8-403(4)) to which the uncertificated security is or may be subject at the time of registration or a statement that there are none of those liens, restrictions, or adverse claims; and

(e) The date the pledge was registered.

(3) Within two business days after the release from pledge of an uncertificated security has been registered, the issuer shall send to the registered owner and the pledgee whose interest was released a written statement containing:

(a) A description of the issue of which the uncertificated security is a part;

(b) The number of shares or units released from pledge;

(c) The name and address and any taxpayer identification number of the registered owner and the pledgee whose interest was released;

(d) A notation of any liens and restrictions of the issuer and any adverse claims (as to which the issuer has duty under G.S. 25-8-403(4)) to which the uncertificated security is or may be subject at the time of registration or a statement that there are none of those liens, restrictions, or adverse claims; and

(e) The date the release was registered.

(4) An "initial transaction statement" is the statement sent to:

(a) The new registered owner and, if applicable, to the registered pledgee pursuant to subsection (1);

(b) The registered pledgee pursuant to subsection (2); or

(c) The registered owner pursuant to subsection (3).

Each initial transaction statement shall be signed by or on behalf of the issuer and must be identified as "initial transaction statement".

(5) Within two business days after the transfer of an uncertificated security has been registered, the issuer shall send to the former registered owner and the former registered pledgee, if any, a written statement containing:

(a) A description of the issue of which the uncertificated security is a part;

(b) The number of shares or units transferred;
(c) The name and address and any taxpayer identification number of the former registered owner and of any former registered pledgee; and
(d) The date the transfer was registered.

(6) At periodic intervals no less frequent than annually and at any time upon the reasonable written request of the registered owner, the issuer shall send to the registered owner of each uncertificated security a dated written statement containing:
(a) A description of the issue of which the uncertificated security is a part;
(b) The name and address and any taxpayer identification number of the registered owner;
(c) The number of shares or units of the uncertificated security registered in the name of the registered owner on the date of the statement;
(d) The name and address and any taxpayer identification number of any registered pledgee and the number of shares or units subject to the pledge; and
(e) A notation of any liens and restrictions of the issuer and any adverse claims (as to which the issuer has duty under G.S. 25-8-403(4)) to which the uncertificated security is or may be subject at the time of registration or a statement that there are none of those liens, restrictions, or adverse claims.

(7) At periodic intervals no less frequent than annually and at any time upon the reasonable written request of the registered pledgee, the issuer shall send to the registered pledgee of each uncertificated security a dated written statement containing:
(a) A description of the issue of which the uncertificated security is a part;
(b) The name and address and any taxpayer identification number of the registered owner;
(c) The name and address and any taxpayer identification number of the registered pledgee;
(d) The number of shares or units subject to the pledge; and
(e) A notation of any liens and restrictions of the issuer and any adverse claims (as to which the issuer has duty under G.S. 25-8-403(4)) to which the uncertificated security is or may be subject at the time of registration or a statement that there are none of those liens, restrictions, or adverse claims.

(8) If the issuer sends the statements described in subsections (6) and (7) at periodic intervals no less frequent than quarterly, the issuer is not obliged to send additional statements upon request unless the owner or pledgee requesting them pays to the issuer the reasonable cost of furnishing them.

(9) Each statement sent pursuant to this section must bear a conspicuous legend reading substantially as follows: "This statement is merely a record of the rights of the addressee as of the time of its issuance. Delivery of this statement, of itself, confers no rights on the recipient. This statement is neither a negotiable instrument nor a security." (1989, c. 588, s. 1.)

AMENDED OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. This section obliges the issuer of uncertificated securities to send certain statements. The required statements are of two types. Transaction statements, required by subsections (1), (2), (3) and (5) are analogous to debit and credit advices and the periodic statements can be reconciled from them. Periodic statements, required by subsections (6) and (7) are analogous to bank statements and will advise owners and pledgees of their positions at given points in time.

The transaction statements, which are mandated upon the registration of transfer, pledge or release, must be sent within two days after the relevant registration, but it is contemplated that such statements will be prepared virtually simultaneously with the actual registration and sent immediately thereafter. They are intended to serve two functions. They are notice to the transferor — (the owner in the case of transfer or pledge, the pledgee in the case of release from pledge, and both the owner and the pledgee in the case of transfer subject to a pledge, transfer of the pledge interest alone or simultaneous transfer and release from pledge) — that his interest has been altered. In the event of fraudulent, unauthorized or otherwise improper registration, the transaction statement will serve as notice that timely action should be taken.

More importantly, these statements are notice to the transferee (new owner in the case of a transfer, pledgee in the case of a pledge, present owner in the case of a release) that the increase of his interest has, in fact, been registered. Furthermore, since all statements except those required by subsection (5) must include a notation of defects or an express statement that there are none, these statements will give the transferee the assurance equivalent to that afforded by a "clean" certificated security and create an estoppel against the issuer. Since registration is the critical step in the transfer of rights, the issuer's transaction statement should include, and the purchaser who receives the statement should be charged with notice of, only those claims, liens and restrictions existing at the time of registration. Compare Section 8-304(2).

It is contemplated that transferees will and should be able to rely on these statements and, in many cases, will not part with their consideration until they receive them. To ensure that the statements will have the desired effect of establishing rights for the transferee against the issuer, subsection (4) requires that the copy of each transaction statement sent to the transferee, called an "initial transaction statement," be signed. Note that Section 1-201(39) does not require a manual signature for compliance with this requirement. Compare also Sections 8-103(b), 8-105(3)(d), 8-202, 8-204(b), 8-205, 8-206, 8-208, 8-304, 8-311, 8-319 and 8-403 for the effects of initial transaction statements.

2. Whenever the issuer registers a transfer of the pledge interest alone, subsections (2) and (3) read together require the issuer to send transaction statements to both the registered owner and the former registered pledgee as well as to the new registered pledgee. Compare Section 8-207(4) and its Comment 1.

3. The frequency of one year, with which periodic statements must be sent to owners and pledgees, is intended to be a minimum requirement for all issuers, including closely held corporations. Owners and pledgees are entitled to request additional statements of position at any time. It is contemplated, however, that publicly held issuers will adopt the practice of sending quarterly statements conforming to the common practice of sending quarterly reports and dividend checks. For those that do, subsection (8) eliminates the obligation to furnish additional statements of position on request unless the issuer is reimbursed for the additional cost.

4. Subsection (9) requires that a conspicuous legend be borne by each statement as a protection against unjustified reliance on statements of uncertificated securities by persons who might deal with them. Except for this requirement and the requirement of subsection (4) that the words "Initial Transaction Statement" be included, the form of the statements required by this section is not prescribed. Perhaps the forms now used by the transfer agents of mutual funds to confirm acquisitions, dispositions, reinvestment of dividends, periodic liquidations and statements of position will serve as a model.

Cross References:
Point 1: Sections 8-103, 8-105, 8-202, 8-204, 8-205, 8-206, 8-208 and 8-304.
Point 2: Section 8-207.

Definitional Cross References:
"Adverse Claim". Section 8-302.
"Conspicuous". Section 1-201.
"Delivery". Section 1-201.
"Issuer". Section 8-201.
"Rights". Section 1-201.
"Security". Section 8-102.
"Send". Section 1-201.
"Signed". Section 1-201.
"Uncertificated Security". Section 8-102.
"Written". Section 1-201.

Editor's Note. — Session Laws 1989, c. 588, s. 3 made this section effective October 1, 1989.

ARTICLE 9.

Secured Transactions; Sales of Accounts and Chattel Paper.

PART 1.

SHORT TITLE, APPLICABILITY AND DEFINITIONS.

§ 25-9-101. Short title.

Legal Periodicals. —
For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions," see 8 Campbell L. Rev. 505 (1986).

CASE NOTES

Cited in Leasing Serv. Corp. v. Crane, 804 F.2d 828 (4th Cir. 1986); Alpiser v. Eagle Pontiac-GMC-Isuzu, Inc., 97 N.C. App. 610, 389 S.E.2d 293 (1990); Sears, Roebuck & Co. v. Vandeusen, 155 Bankr. 358 (E.D.N.C. 1993).

§ 25-9-102. Policy and subject matter of article.

Legal Periodicals. —
For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions," see 8 Campbell L. Rev. 505 (1986).

CASE NOTES

Applicability of Article 9. — This Article applies to a transaction intended to create a security interest, regardless of whom the certificate lists as the owner. Carter v. Holland (In re Carraway), 65 Bankr. 51 (Bankr. E.D.N.C. 1986).

Security interest in a mobile home which was moveable, tangible property, was governed by Article 9 of the UCC Section 41-2.5(a), which provides that when a husband and wife become co-owners of a mobile home, in the absence of anything to the contrary appearing in the instrument of title, they become tenants by the entirety with all the incidents of an estate by the entirety in real property, did not dictate a contrary result. Joyce v. Cloverbrook Homes, Inc., 81 N.C. App. 270, 344 S.E.2d 58, cert. denied, 317 N.C. 704, 347 S.E.2d 42 (1986).

Applied in A.E. Pennebaker Co. v.

Fuller, 691 F. Supp. 938 (W.D.N.C. 1988).

§ 25-9-103. Perfection of security interests in multiple-state transactions.

(1) Documents, Instruments and Ordinary Goods. —

(a) This subsection applies to documents and instruments and to goods other than those covered by a certificate of title described in subsection (2), mobile goods described in subsection (3), and minerals described in subsection (5).

(b) Except as otherwise provided in this subsection, perfection and the effect of perfection or nonperfection of a security interest in collateral are governed by the law of the jurisdiction where the collateral is when the last event occurs on which is based the assertion that the security interest is perfected or unperfected.

(c) If the parties to a transaction creating a purchase money security interest in goods in one jurisdiction understand at the time that the security interest attaches that the goods will be kept in another jurisdiction, then the law of the other jurisdiction governs the perfection and the effect of perfection or nonperfection of the security interest from the time it attaches until 30 days after the debtor receives possession of the goods and thereafter if the goods are taken to the other jurisdiction before the end of the 30-day period.

(d) When collateral is brought into and kept in this State while subject to a security interest perfected under the law of the jurisdiction from which the collateral was removed, the security interest remains perfected, but if action is required by part 3 of this article to perfect the security interest,

(i) if the action is not taken before the expiration of the period of perfection in the other jurisdiction or the end of four months after the collateral is brought into this State, whichever period first expires, the security interest becomes unperfected at the end of that period and is thereafter deemed to have been unperfected as against a person who became a purchaser after removal;

(ii) if the action is taken before the expiration of the period specified in subparagraph (i), the security interest continues perfected thereafter;

(iii) for the purpose of priority over a buyer of consumer goods (subsection (2) of G.S. 25-9-307), the period of the effectiveness of a filing in the jurisdiction from which the collateral is removed is governed by the rules with respect to perfection in subparagraphs (i) and (ii).

(2) Certificate of Title. —

(a) This subsection applies to goods covered by a certificate of title issued under a statute of this State or of another jurisdiction under the law of which indication of a security interest on the certificate is required as a condition of perfection.

(b) Except as otherwise provided in this subsection, perfection and the effect of perfection or nonperfection of the security interest are governed by the law (including the conflict of laws rules) of the jurisdiction issuing the certificate until four months after the goods are removed from that jurisdiction and thereafter until the goods are registered in another jurisdiction, but in any event not beyond surrender of the certificate. After the expiration of that period, the goods are not covered by the certificate of title within the meaning of this section.

(c) Except with respect to the rights of a buyer described in the next paragraph, a security interest, perfected in another jurisdiction otherwise than by notation on a certificate of title, in goods brought into this State and thereafter covered by a certificate of title issued by this State is subject to the rules stated in paragraph (d) of subsection (1).

(d) If goods are brought into this State while a security interest therein is perfected in any manner under the law of the jurisdiction from which the goods are removed and a certificate of title is issued by this State and the certificate does not show that the goods are subject to the security interest or that they may be subject to security interests not shown on the certificate, the security interest is subordinate to the rights of a buyer of the goods who is not in the business of selling goods of that kind to the extent that he gives value and receives delivery of the goods after issuance of the certificate and without knowledge of the security interest.

(3) Accounts, General Intangibles and Mobile Goods. —

(a) This subsection applies to accounts (other than an account described in subsection (5) on minerals) and general intangibles (other than uncertificated securities) and to goods which are mobile and which are of a type normally used in more than one jurisdiction, such as motor vehicles, trailers, rolling stock, airplanes, shipping containers, road-building and construction machinery and commercial harvesting machinery and the like, if the goods are equipment or are inventory leased or held for lease by the debtor to others, and are not covered by a certificate of title described in subsection (2).

(b) The law (including the conflict of laws rules) of the jurisdiction in which the debtor is located governs the perfection and the effect of perfection or nonperfection of the security interest.

(c) If, however, the debtor is located in a jurisdiction which is not a part of the United States, and which does not provide for perfection of the security interest by filing or recording in that jurisdiction, the law of the jurisdiction in the United States in which the debtor has its major executive office in the United States governs the perfection and the effect of perfection or nonperfection of the security interest through filing. In the alternative, if the debtor is located in a jurisdiction which is not a part of the United States or Canada and the collateral is accounts or general intangibles for money due or to become due, the security interest may be perfected by notification to the account debtor. As used in this paragraph, "United States" includes its territories and possessions and the Commonwealth of Puerto Rico.

(d) A debtor shall be deemed located at his place of business if he has one, at his chief executive office if he has more than one place of business, otherwise at his residence. If, however, the debtor is a foreign air carrier under the Federal Aviation Act of 1958, as amended, it shall be deemed located at the designated office of the agent upon whom service of process may be made on behalf of the foreign air carrier.

(e) A security interest perfected under the law of the jurisdiction of the location of the debtor is perfected until the expiration of four months after a change of the debtor's location to another jurisdiction, or until perfection would have ceased by the law of the first jurisdiction, whichever period first expires. Unless perfected in the new jurisdiction before the end of that period, it becomes unperfected thereafter and is deemed to have been unperfected as against a person who became a purchaser after the change.

(4) Chattel Paper. — The rules stated for goods in subsection (1) apply to a possessory security interest in chattel paper. The rules stated for accounts in subsection (3) apply to a nonpossessory security interest in chattel paper, but the security interest may not be perfected by notification to the account debtor.

(5) Minerals. — Perfection and the effect of perfection or nonperfection of a security interest which is created by a debtor who has an interest in minerals or the like (including oil and gas) before extraction and which attaches thereto as extracted, or which attaches to an account resulting from the sale thereof at the wellhead or minehead, are governed by the law (including the conflict of laws rules) of the jurisdiction wherein the wellhead or minehead is located.

(6) Uncertificated Securities. — The law (including the conflict of laws rules) of the jurisdiction of organization of the issuer governs the perfection and the effect of perfection or nonperfection of a security interest in uncertificated securities. (1945, c. 196, s. 2; 1957, c. 564; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 1989 (Reg. Sess., 1990), c. 1024, s. 8(e), (f).)

Editor's Note. — The amendment by 1989 (Reg. Sess., 1990), c. 1024, s. 8(e), (f) was a conforming amendment to the amendments to Article 8 of this Chapter that were adopted in 1989.

Effect of Amendments. — The 1989 (Reg. Sess., 1990) amendment, effective July 27, 1990, added "(other than uncertificated securities)" following "general intangibles" in subdivision (3)(a), and added subsection (6).

CASE NOTES

Cited in Carter v. Holland (In re Carraway), 65 Bankr. 51 (Bankr. E.D.N.C. 1986); NCNB Nat'l Bank v. Major Leasing, Inc., 140 Bankr. 826 (Bankr. N.D. Ga. 1991).

§ 25-9-104. Transactions excluded from article.

CASE NOTES

Article 9 does not apply where collateral consists of unearned insurance premiums. In re Universal Motor Express, Inc., 72 Bankr. 208 (Bankr. W.D.N.C. 1987).

Right of Setoff. — Subdivision (i) of this section, which specifically excludes any right of setoff from Article 9 of the UCC, merely removes the right of setoff from the filing and perfection requirements of Article 9 and does not affect the applicability of the Article's priority rules when a security interest is involved. Branch Banking & Trust Co. v. Columbian Peanut Co., 649 F. Supp. 1116 (E.D.N.C. 1986).

Stated in In re Laues, 90 Bankr. 158 (Bankr. E.D.N.C. 1988); Zorba's Inn, Inc. v. Nationwide Mut. Fire Ins. Co., 93 N.C. App. 332, 377 S.E.2d 797 (1989).

§ 25-9-105. Definitions and index of definitions.

(1) In this article unless the context otherwise requires:

(a) "Account debtor" means the person who is obligated on an account, chattel paper or general intangible;

(b) "Chattel paper" means a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods, but a charter or other contract involving the use or hire of a vessel is not chattel paper. When a transaction is evidenced both by such a security agreement or a lease and by an instrument or a series of instruments, the group of writings taken together constitutes chattel paper;

(c) "Collateral" means the property subject to a security interest, and includes accounts and chattel paper which have been sold;

(d) "Debtor" means the person who owes payment or other performance of the obligation secured, whether or not he owns or has rights in the collateral, and includes the seller of accounts or chattel paper. Where the debtor and the owner of the collateral are not the same person, the term "debtor" means the owner of a collateral in any provision of the article dealing with the collateral, the obligor in any provision dealing with the obligation, and may include both where the context so requires;

(e) "Deposit account" means a demand, time, savings, passbook or like account maintained with a bank, savings and loan association, credit union or like organization, other than an account evidenced by a certificate of deposit;

(f) "Document" means document of title as defined in the general definitions of article 1 (G.S. 25-1-201), and a receipt of the kind described in subsection (2) of G.S. 25-7-201;

(g) "Encumbrance" includes real estate mortgages and other liens on real estate and all other rights in real estate that are not ownership interests;

(h) "Goods" includes all things which are movable at the time the security interest attaches or which are fixtures (G.S. 25-9-313), but does not include money, documents, instruments, accounts, chattel paper, general intangibles, or minerals or the like (including oil and gas) before extraction. "Goods" also includes standing timber which is to be cut and removed under a conveyance or contract for sale, the unborn young of animals, and growing crops;

(i) "Instrument" means a negotiable instrument (defined in G.S. 25-3-104), or a certificated security (defined in G.S. 25-8-102) or any other writing which evidences a right to the payment of money and is not itself a security agreement or lease and is of a type which is in ordinary course of business transferred by delivery with any necessary indorsement or assignment;

(j) "Mortgage" means a consensual interest created by a real estate mortgage, a trust deed on real estate, or the like;

(k) An advance is made "pursuant to commitment" if the secured party has bound himself to make it, whether or not a subsequent event of default or other event not within his control has relieved or may relieve him from his obligation;

(*l*) "Security agreement" means an agreement which creates or provides for a security interest;

(m) "Secured party" means a lender, seller or other person in whose favor there is a security interest, including a person to whom accounts or chattel paper have been sold. When the holders of obligations issued under an indenture of trust, equipment trust agreement or the like are represented by a trustee or other person, the representative is the secured party.

(2) Other definitions applying to this article and the sections in which they appear are:

"Account." (G.S. 25-9-106).
"Attach." (G.S. 25-9-203).
"Construction mortgage." (G.S. 25-9-313(1)).
"Consumer goods." (G.S. 25-9-109(1)).
"Equipment." (G.S. 25-9-109(2)).
"Farm products." (G.S. 25-9-109(3)).
"Fixture." (G.S. 25-9-313(1)).
"Fixture filing." (G.S. 25-9-313(1)).
"General intangibles." (G.S. 25-9-106).
"Inventory." (G.S. 25-9-109(4)).
"Lien creditor." (G.S. 25-9-301(3)).
"Proceeds." (G.S. 25-9-306(1)).
"Purchase money security interest." (G.S. 25-9-107).
"United States." (G.S. 25-9-103).

(3) The following definitions in other articles apply to this article:

"Check." (G.S. 25-3-104).
"Contract for sale." (G.S. 25-2-106).
"Holder in due course." (G.S. 25-3-302).
"Note." (G.S. 25-3-104).
"Sale." (G.S. 25-2-106).

(4) In addition article 1 contains general definitions and principles of construction and interpretation applicable throughout this article. (1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 1989 (Reg. Sess., 1990), c. 1024, s. 8(g).)

Editor's Note. — The amendment by 1989 (Reg. Sess., 1990), c. 1024, s. 8(g) was a conforming amendment to the amendments to Article 8 of this Chapter that were adopted in 1989.

Effect of Amendments. — The 1989

(Reg. Sess., 1990) amendment, effective July 27, 1990, inserted "certificated" in subdivision (1)(i).

Legal Periodicals. — For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions, " see 8 Campbell L. Rev. 505 (1986).

CASE NOTES

Guarantor Not a Debtor. — The definition of the term "debtor" under this section does not include guarantors. Community Bank & Trust Co. v. Copses, 953 F.2d 133 (4th Cir. 1991).

"Secured party" is not synonymous with "titleholder" and holding title is not a prerequisite to being a secured party within the context of § 25-9-505(1). Lincoln v. Grinstead, 94 N.C. App. 122, 379 S.E.2d 671 (1989).

Husband Was Secured Party Although Title Was in Wife's Name. — Trial court did not commit error by treating husband as the converter of the motor vehicle even though the repossessed vehicle was titled in his wife's name only; where record revealed that defendant husband negotiated with plaintiff throughout the financial transaction regarding the sale of the vehicle, represented to plaintiff that the vehicle's transmission was in good condition, signed the sales agreement conveying the truck to plaintiff, and completed repossession forms with the Department of Motor Vehicles, husband was a party to sales agreement which created a security interest in the vehicle, and therefore was subject to the provisions of § 25-9-505 pertaining to compulsory disposition of collateral. Lincoln v. Grinstead, 94 N.C. App. 122, 379 S.E.2d 671 (1989).

"Instrument". — In light of the prevailing commercial practices and the purpose of the Uniform Commercial Code (U.C.C.), there exists no compelling reason to classify credit card slips as instruments. They are nontransferable, they are not generally presented back to the issuer in the collection process, and creditors usually have no access to the clearinghouse procedure through which they are paid. Classifying credit card slips as instruments would frustrate prevailing commercial practices. First Union Nat'l Bank v. Brendle's Stores, Inc., 165 Bankr. 811 (M.D.N.C. 1993).

Maker of a note secured by a deed of trust was obligated to make payments to possessor of the note and deed of trust until the note was paid in full. A.E. Pennebaker Co. v. Fuller, 691 F. Supp. 938 (W.D.N.C. 1988).

Security interest in a mobile home which was moveable, tangible property, was governed by Article 9 of the UCC Section 41-2.5(a), which provides that when a husband and wife become co-owners of a mobile home, in the absence of anything to the contrary appearing in the instrument of title, they become tenants by the entirety with all the incidents of an estate by the entirety in real property, did not dictate a contrary result. Joyce v. Cloverbrook Homes, Inc., 81 N.C. App. 270, 344 S.E.2d 58, cert. denied, 317 N.C. 704, 347 S.E.2d 42 (1986).

Quoted in Gregory Poole Equip. Co. v. Murray, 105 N.C. App. 642, 414 S.E.2d 563 (1992).

§ 25-9-107. Definitions: "Purchase money security interest."

A security interest is a "purchase money security interest" to the extent that it is

(a) taken or retained by the seller of the collateral to secure all or part of its price; or

(b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

A purchase money security interest under this section will continue in the collateral when the underlying security agreement is refinanced or modified with the same creditor. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 1993, c. 370, s. 1.)

Effect of Amendments. — The 1993 amendment, effective October 1, 1993, added the second paragraph.

CASE NOTES

Consolidation of Loans Did Not Destroy Security Interest. — Consolidation of three loan agreements by creditor did not destroy its purchase money security interest in the tools it sold to the debtors. In re Sherman, 126 Bankr. 684 (Bankr. E.D.N.C. 1987).

§ 25-9-109. Classification of goods: "Consumer goods"; "equipment"; "farm products"; "inventory."

CASE NOTES

Agreement That Items Affixed to House Remained Personalty Did Not Bind Third Parties. — While the contract provided that the windows and gutters which were affixed to the house remained personal property, and such an agreement may be valid between the parties to the contract, it is not binding when third parties become involved. In re Hinson, 77 Bankr. 34 (Bankr. M.D.N.C. 1987).

A mobile home is a consumer good. Joyce v. Cloverbrook Homes, Inc., 81 N.C. App. 270, 344 S.E.2d 58, cert. denied, 317 N.C. 704, 347 S.E.2d 42 (1986).

Financing Statement Not Required. — Where defendant purchased a VCR from plaintiff and he signed a purchase money security agreement, thereby granting plaintiff a purchase money security interest in the VCR, since a VCR is a consumer good plaintiff did not have to file a financing statement in order to perfect its purchase money security interest in the VCR; therefore, when defendant failed to make any further payments for the VCR and defaulted on the security agreement, the plaintiff was entitled to recover possession of the VCR when it filed its action in small claims court. Kimbrell's of Sanford, N.C., Inc. v. KPS, Inc., 113 N.C. App. 830, 440 S.E.2d 329 (1994).

Stated in City Fin. Co. v. Massey Motor Co., 95 N.C. App. 623, 383 S.E.2d 454 (1989); United States v. Currituck Grain, Inc., 6 F.3d 200 (4th Cir. 1993).

§ 25-9-112. Where collateral is not owned by debtor.

CASE NOTES

This section expands on the definition of § 25-9-105 by describing the secured party's obligations to an owner of collateral who is not the debtor. Gregory Poole Equip. Co. v. Murray, 105 N.C. App. 642, 414 S.E.2d 563 (1992).

§ 25-9-113. Security interests arising under article on sales or under article on leases.

A security interest arising solely under the article on sales (Article 2) or the article on leases (Article 2A) is subject to the provisions of this article except that to the extent that and so long as the debtor does not have or does not lawfully obtain possession of the goods.

(a) no security agreement is necessary to make the security interest enforceable; and
(b) no filing is required to perfect the security interest; and
(c) the rights of the secured party on default by the debtor are governed (i) by the article on sales (Article 2) in the case of a security interest arising solely under that Article, or (ii) by the article on leases (Article 2A) in the case of a security interest arising solely under that Article. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 1993, c. 463, s. 3.)

Effect of Amendments. — The 1993 amendment, effective October 1, 1993, but not applicable to pending litigation, in the first paragraph substituted "sales or under article on leases" for "sales" in the catchline to this section; substituted "(Article 2) or the article on leases (Article 2A)" for "(article 2)"; and in subdivision (c) substituted "(Article 2) in the case of a security interest arising solely under that Article, or (ii) by the article on leases (Article 2A) in the case of a security interest arising solely under that Article" for "(article 2)".

PART 2.

VALIDITY OF SECURITY AGREEMENT AND RIGHTS OF PARTIES THERETO.

§ 25-9-201. General validity of security agreement.

CASE NOTES

I. General Consideration.

I. GENERAL CONSIDERATION.

Priority of Perfected Security Interest. — The bank's perfected security interest in the debtor's peanut crop had priority over the right of setoff of the peanut company created subsequent thereto, whereby the company furnished peanut seed to the debtors in exchange for their agreement to convey a quantity of matured peanuts to the company. Branch Banking & Trust Co. v. Columbian Peanut Co., 649 F. Supp. 1116 (E.D.N.C. 1986).

Stated in Whirlpool Corp. v. Dailey Constr., Inc., 110 N.C. App. 468, 429 S.E.2d 748 (1993).

§ 25-9-202. Title to collateral immaterial.

CASE NOTES

Applicability of Article 9. — This Article applies to a transaction intended to create a security interest, regardless of whom the certificate lists as the owner. Carter v. Holland (In re Carraway), 65 Bankr. 51 (Bankr. E.D.N.C. 1986).

§ 25-9-203. Attachment and enforceability of security interest; proceeds; formal requisites.

(1) Subject to the provisions of G.S. 25-4-208 on the security interest of a collecting bank, G.S. 25-8-321 on security interests in securities and G.S. 25-9-113 on a security interest arising under the article on sales, a security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless

(a) the collateral is in the possession of the secured party pursuant to agreement, or the debtor has signed a security agreement which contains a description of the collateral and in addition, when the security interest covers crops growing or to be grown or timber to be cut, a description of the land concerned; and

(b) value has been given; and

(c) the debtor has rights in the collateral.

(2) A security interest attaches when it becomes enforceable against the debtor with respect to the collateral. Attachment occurs as soon as all of the events specified in subsection (1) have taken place unless explicit agreement postpones the time of attaching.

(3) Unless otherwise agreed a security agreement gives the secured party the rights to proceeds provided by G.S. 25-9-306.

(4) A transaction, although subject to this article, is also subject to the North Carolina Consumer Finance Act (being G.S. 53-164 through 53-191), G.S. 24-1 and 24-2, the Pawnbrokers Modernization Act of 1989 (being Chapter 91A of the General Statutes), the Retail Installment Sales Act (being Chapter 25A of the North Carolina General Statutes), and in the case of conflict between the provisions of this article and any such statute, the provisions of such statute control. Failure to comply with any applicable statute has only the effect which is specified therein. (1866-7, c. 1, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C.S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 182, s. 2; c. 196, s. 2; 1955, c. 386, s. 1; c. 816; 1957, cc. 564, 999; 1961, c. 574; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 1989 (Reg. Sess., 1990), c. 1024, ss. 8(h), 10(a).)

Editor's Note. — The amendment by 1989 (Reg. Sess., 1990), c. 1024, s. 8(h) is a conforming amendment to the amendments to Article 8 of this Chapter that were adopted in 1989.

Effect of Amendments. — The 1989 (Reg. Sess., 1990) amendment, effective July 27, 1990, inserted ", G.S. 25-8-321 on security interests in securities" in the introductory language of subsection (1), and substituted "the Pawnbrokers Modernization Act of 1989 (being Chapter 91A of the General Statutes)" for "and G.S. 91-1 through 91-8" in subsection (4).

Legal Periodicals. —

For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions," see 8 Campbell L. Rev. 505 (1986).

CASE NOTES

This statute does not make an Article 9 transaction subject to § 24-1.1. Borg-Warner Acceptance Corp. v. Johnston, 107 N.C. App. 174, 419 S.E.2d 195 (1992), cert. denied, 333 N.C. 254, 424 S.E.2d 918 (1993).

Right to Insurance Proceeds. — Unless otherwise agreed, a security agreement gives the secured party the rights to proceeds, including insurance proceeds. Zorba's Inn, Inc. v. Nationwide Mut. Fire Ins. Co., 93 N.C. App. 332, 377 S.E.2d 797 (1989).

The mere fact that plaintiff had a security interest was insufficient to give rise to a claim against defendant under Article 9 or otherwise. Zorba's Inn, Inc. v. Nationwide Mut. Fire Ins. Co., 93 N.C. App. 332, 377 S.E.2d 797 (1989).

§ 25-9-206. Agreement not to assert defenses against assignee; modification of sales warranties where security agreement exists.

CASE NOTES

This section applies to leases, whether or not they constitute secured transactions. Leasing Serv. Corp. v. Crane, 804 F.2d 828 (4th Cir. 1986).

This section governed lease of drill and truck, even if the lease was not a transaction intended to create a security interest. Leasing Serv. Corp. v. Crane, 804 F.2d 828 (4th Cir. 1986).

Handwritten agreement between lessees/obligators and representative of lessor/obligee limiting remedies did not qualify as a defense which could be asserted against assignee as a limitation of remedies. Leasing Serv. Corp. v. Crane, 804 F.2d 828 (4th Cir. 1986).

PART 3.

RIGHTS OF THIRD PARTIES; PERFECTED AND UNPERFECTED SECURITY INTERESTS; RULES OF PRIORITY.

§ 25-9-301. Persons who take priority over unperfected security interests; rights of "lien creditor."

Legal Periodicals. — For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions," see 8 Campbell L. Rev. 505 (1986).

CASE NOTES

It is the exclusion of third parties which is the essence of perfection of a security interest. Westchase I Assocs. v. Lincoln Nat'l Life Ins. Co., 126 Bankr. 692 (W.D.N.C. 1991).

Under North Carolina law a judicial lien creditor has priority over an unperfected lien on a personal property. In re Millerburg, 61 Bankr. 125 (Bankr. E.D.N.C. 1986).

One of the positions occupied by the bankruptcy trustee and debtor in possession is that of judicial lien creditor, and as between a Chapter 11 debtor in possession and a creditor with an unperfected lien on personal property, the debtor in possession will prevail. In re Millerburg, 61 Bankr. 125 (Bankr. E.D.N.C. 1986).

Lender with Perfected Security Interest in Note Had Priority Over Unperfected Lender of Same Note. — Where debtor used the same note as collateral for loans from two separate lenders, the lender with a perfected security interest in the note, due to his possession of it, had priority over the unperfected lender and was entitled to collect all or any portion of the note as agreed by the debtor until paid in full, and had no liability to the unperfected lender. A.E. Pennebaker Co. v. Fuller, 691 F. Supp. 938 (W.D.N.C. 1988).

Security Interests in Motor Vehicles. — With reference to vehicles subject to registration with the Division of Motor Vehicles, the provisions of § 20-58 et seq. are the exclusive statutory authority governing the perfecting of security interests in motor vehicles. In re Holder, 94 Bankr. 395 (Bankr. M.D.N.C. 1988), aff'd, 892 F.2d 29 (4th Cir. 1989).

This section does not establish the perfection date for security interests in vehicles, but rather establishes a grace period of 20 days after the debtor receives possession of the collateral for perfection by filing of purchase money security interests in personal property. In re Holder, 94 Bankr. 395 (Bankr. M.D.N.C. 1988), aff'd, 892 F.2d 29 (4th Cir. 1989).

Creditor who did not file financing statement did not have perfected purchase money security interest in windows and gutters which were attached to and became a part of a house as over against the trustee in bankruptcy. In re Hinson, 77 Bankr. 34 (Bankr. M.D.N.C. 1987).

Applied in United States v. Currituck Grain, Inc., 6 F.3d 200 (4th Cir. 1993).

§ 25-9-302. When filing is required to perfect security interests; security interests to which filing provisions of this article do not apply.

(1) A financing statement must be filed to perfect all security interests except the following:

(a) a security interest in collateral in possession of the secured party under G.S. 25-9-305;

(b) a security interest temporarily perfected in instruments or documents without delivery under G.S. 25-9-304 or in proceeds for a 10-day period under G.S. 25-9-306;

(c) a security interest created by an assignment of a beneficial interest in a trust or a decedent's estate;

(d) a purchase money security interest in consumer goods; but compliance with G.S. 20-58 et seq. is required for a motor vehicle required to be registered; and fixture filing is required for priority over conflicting interests in fixtures to the extent provided in G.S. 25-9-313;

(e) an assignment of accounts which does not alone or in conjunction with other assignments to the same assignee transfer a significant part of the outstanding accounts of the assignor;

(f) a security interest of a collecting bank (G.S. 25-4-208) or in securities (G.S. 25-8-321) or arising under the article on sales (see G.S. 25-9-113) or covered in subsection (3) of this section;

(g) an assignment for the benefit of all the creditors of the transferor, and subsequent transfers by the assignee thereunder.

(2) If a secured party assigns a perfected security interest, no filing under this article is required in order to continue the perfected status of the security interest against creditors of and transferees from the original debtor.

(3) The filing of a financing statement otherwise required by this article is not necessary or effective to perfect a security interest in property subject to

(a) a statute or treaty of the United States which provides for a national or international registration or a national or international certificate of title or which specifies a place of filing different from that specified in this article for filing of the security interest; or

(b) the following statute of this State: G.S. 20-58 et seq. as to any personal property required to be registered pursuant to Chapter 20 of the General Statutes; but during any period in which collateral is inventory held for sale by a person who is in the business of selling goods of that kind, the filing provisions of this article (part 4) apply to a security interest in that collateral created by him as debtor; or

(c) a certificate of title statute of another jurisdiction under the law of which indication of a security interest on the certificate is required as a condition of perfection (subsection (2) of G.S. 25-9-103).

(4) Compliance with a statute or treaty described in subsection (3) is equivalent to the filing of a financing statement under this article, and a security interest in property subject to the statute or treaty can be perfected only by compliance therewith except as provided in G.S. 25-9-103 on multiple-state transactions. Duration and renewal of perfection of a security interest perfected by compliance with the statute or treaty are governed by the provisions of the statute or treaty; in other respects the security interest is subject to this article.

(5) The filing provisions of this article do not apply to a security interest in property of any description or any interest therein created by a deed of trust or mortgage made by a public utility as defined in G.S. 62-3(23), or by any electric or telephone membership corporation domesticated or incorporated in North Carolina, but the deed of trust or mortgage shall be registered in the county or counties in which such deed of trust or mortgage is required by G.S. 47-20 to be registered, and all such instruments, including those creating security interests in personal property, shall be recorded in the real property records and indexed in the real property indexes.

(6) The filing provisions of this article do not apply to any security interest created in connection with the issuance of any bond, note or other evidence of indebtedness for borrowed money by this State or any political subdivision or agency thereof. (1866-7, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C.S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 182, s. 3; c. 196, s. 2; 1955, c. 816; 1957, cc. 564, 999; 1961, c. 574; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 1977, c. 103; 1989 (Reg. Sess., 1990), c. 1024, s. 8(i).)

Cross References. — As to authorization for consumer finance licensee under Article 15 of Chapter 53 to collect from borrower recording fees required pursuant to § 25-9-302 et seq., see § 53-177.

Editor's Note. — The amendment by 1989 (Reg. Sess., 1990), c. 1024, s. 8(i) was a conforming amendment to the amendments to Article 8 of this Chapter that were adopted in 1989.

Effect of Amendments. — The 1989 (Reg. Sess., 1990) amendment, effective July 27, 1990, inserted "or in securities (G.S. 25-8-321)" in subdivision (1)(f).

Legal Periodicals. —

For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions," see 8 Campbell L. Rev. 505 (1986).

CASE NOTES

Article Inapplicable to Motor Vehicles, etc. —

With reference to vehicles subject to registration with the Division of Motor Vehicles, the provisions of § 20-58 et seq. are the exclusive statutory authority governing the perfecting of security interests in motor vehicles. In re Holder, 94 Bankr. 395 (Bankr. M.D.N.C. 1988), aff'd, 892 F.2d 29 (4th Cir. 1989).

Creditor who did not file financing statement did not have perfected purchase money security interest in windows and gutters which were attached to and became a part of a house as over against the trustee in bankruptcy. In re Hinson, 77 Bankr. 34 (Bankr. M.D.N.C. 1987).

A security interest in a mobile home is subject to the same perfection requirements as an automobile. Carter v. Holland (In re Carraway), 65 Bankr. 51 (Bankr. E.D.N.C. 1986).

Based on the language of § 20-58 et seq., the legislature intended that this statute provide the exclusive method for a first mortgagee to perfect a security interest in a mobile home. Peoples Sav. & Loan Assoc. v. Citicorp Acceptance Co., 103 N.C. App. 762, 407 S.E.2d 251, cert. denied, 330 N.C. 197, 412 S.E.2d 59 (1991).

Financing Statement Not Required. — Where defendant purchased a VCR from plaintiff and, he signed a purchase money security agreement, thereby granting plaintiff a purchase money security interest in the VCR, since a VCR is a consumer good plaintiff did not have to file a financing statement in order to perfect its purchase money security interest in the VCR; therefore, when defendant failed to make any further payments for the VCR and defaulted on the security agreement, the plaintiff was entitled to recover possession of the VCR when it filed its action in small claims court. Kimbrell's of Sanford, N.C., Inc. v. KPS, Inc., 113 N.C. App. 830, 440 S.E.2d 329 (1994).

Interruption of Possession. — Where no exception was made to trial court's ruling that sheriff's levy (for plaintiff) interrupted defendant's possession of collateral, and defendant claimed perfected security interest in the property by possession, that ruling became law of the case; therefore, since defendant's lien perfection was based only on possession of the collateral and sheriff's levy interrupted that possession in this case, court erred in finding defendant had priority over plaintiff, despite dicta by Court of Appeal indicating prior perfected security interest by possession would have priority over subsequent sheriff's levy of same property. Waterhouse v. Carolina Limousine Mfg., Inc., 96 N.C. App. 109, 384 S.E.2d 293, cert. denied, 326 N.C. 54, 389 S.E.2d 107 (1990).

Cited in In re Millerburg, 61 Bankr. 125 (Bankr. E.D.N.C. 1986); Sears, Roebuck & Co. v. Vandeusen, 155 Bankr. 358 (E.D.N.C. 1993).

§ 25-9-303. When security interest is perfected; continuity of perfection.

Legal Periodicals. —

For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions," see 8 Campbell L. Rev. 505 (1986).

§ 25-9-304. Perfection of security interest in instruments, documents, and goods covered by documents; perfection by permissive filing; temporary perfection without filing or transfer of possession.

(1) A security interest in chattel paper or negotiable documents may be perfected by filing. A security interest in money or instruments (other than certificated securities or instruments which con-

stitute part of chattel paper) can be perfected only by the secured party's taking possession, except as provided in subsections (4) and (5) of this section and subsections (2) and (3) of G.S. 25-9-306 on proceeds.

(2) During the period that goods are in the possession of the issuer of a negotiable document therefor, a security interest in the goods is perfected by perfecting a security interest in the document, and any security interest in the goods otherwise perfected during such period is subject thereto.

(3) A security interest in goods in the possession of a bailee other than one who has issued a negotiable document therefor is perfected by issuance of a document in the name of the secured party or by the bailee's receipt of notification of the secured party's interest or by filing as to the goods.

(4) A security interest in instruments (other than certificated securities) or negotiable documents is perfected without filing or the taking of possession for a period of 21 days from the time it attaches to the extent that it arises for new value given under a written security agreement.

(5) A security interest remains perfected for a period of 21 days without filing where a secured party having a perfected security interest in an instrument (other than a certificated security), a negotiable document or goods in possession of a bailee other than one who has issued a negotiable document therefor

(a) makes available to the debtor the goods or documents representing the goods for the purpose of ultimate sale or exchange or for the purpose of loading, unloading, storing, shipping, transshipping, manufacturing, processing or otherwise dealing with them in a manner preliminary to their sale or exchange, but priority between conflicting security interests in the goods is subject to subsection (3) of G.S. 25-9-312; or

(b) delivers the instrument to the debtor for the purpose of ultimate sale or exchange or of presentation, collection, renewal or registration of transfer.

(6) After the 21-day period in subsections (4) and (5) perfection depends upon compliance with applicable provisions of this article. (1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 1989 (Reg. Sess., 1990), c. 1024, s. 8(j)-(l).)

Editor's Note. — The amendment by 1989 (Reg. Sess., 1990), c. 1024, s. 8(j)-(l) was a conforming amendment to the amendments to Article 8 of this Chapter that were adopted in 1989.

Effect of Amendments. — The 1989 (Reg. Sess., 1990) amendment, effective July 27, 1990, inserted "certificated securities or" in the parenthetical in the second sentence of subsection (1), inserted "(other than certificated securities)" following "instruments" in subsection (4), and inserted "(other than a certificated security)" in the introductory language of subsection (5).

CASE NOTES

Creditor Remains Perfected Where Substance of Debt Does Not Change. — Where creditor had a perfected security interest in debtor's accounts receivable, debtor exchanged the accounts receivable owed to it for promissory notes, and the transaction which transformed the accounts receivable into notes was done by related, if not identical, parties and was never disclosed to creditor, the substance of the debt had not changed and creditor remained perfected in the accounts receivable, even though they presently existed in the form of promissory notes and the creditor did not have possession of those notes as required by this section. In re Guil-Park Farms, Inc., 90 Bankr. 180 (Bankr. W.D.N.C. 1988).

Stated in A.E. Pennebaker Co. v. Fuller, 691 F. Supp. 938 (W.D.N.C. 1988).

Cited in First Union Nat'l Bank v. Brendle's Stores, Inc., 165 Bankr. 811 (M.D.N.C. 1993).

§ 25-9-305. When possession by secured party perfects security interest without filing.

A security interest in letters of credit and advices of credit (subsection (2)(a) of G.S. 25-5-116), goods, instruments (other than certificated securities), money, negotiable documents or chattel paper may be perfected by the secured party's taking possession of the collateral. If such collateral other than goods covered by a negotiable document is held by a bailee, the secured party is deemed to have possession from the time the bailee receives notification of the secured party's interest. A security interest is perfected by possession from the time possession is taken without relation back and continues only so long as possession is retained, unless otherwise specified in this article. The security interest may be otherwise perfected as provided in this article before or after the period of possession by the secured party. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 1989 (Reg. Sess., 1990), c. 1024, s. 8(k).)

Editor's Note. — The amendment by 1989 (Reg. Sess., 1990), c. 1024, s. 8(k) was a conforming amendment to the amendments to Article 8 of this Chapter that were adopted in 1989.

Effect of Amendments. — The 1989 (Reg. Sess., 1990) amendment, effective July 27, 1990, inserted "(other than certificated securities)" following "instruments" in the first sentence.

CASE NOTES

Where defendant had a perfected security interest in a note due to possession of that note when the maker thereof used the note as collateral to secure a loan from plaintiff, plaintiff's security agreement was subject to defendant's security interest. A.E. Pennebaker Co. v. Fuller, 691 F. Supp. 938 (W.D.N.C. 1988).

Interruption of Possession. — Where no exception was made to trial court's ruling that sheriff's levy (for plaintiff) interrupted defendant's possession of collateral, and defendant claimed perfected security interest in the property by possession, that ruling became law of the case; therefore, since defendant's lien perfection was based only on possession of the collateral and sheriff's levy interrupted that possession in this case, court erred in finding defendant had priority over plaintiff, despite dicta by Court of Appeal indicating prior perfected security interest by possession would have priority over subsequent sheriff's levy of same property. Waterhouse v. Carolina Limousine Mfg., Inc., 96 N.C. App. 109, 384 S.E.2d 293, cert. denied, 326 N.C. 54, 389 S.E.2d 107 (1990).

§ 25-9-306. "Proceeds"; secured party's rights on disposition of collateral.

Legal Periodicals. — For comment on "Entrustment Under U.C.C. Section 2-403 and its Implications for Article 9," see 9 Campbell L. Rev. 407 (1987).

CASE NOTES

"Proceeds". — Although the peanut company gave value to the debtors at the time of its receipt of the matured peanuts which the debtors had agreed to convey in exchange for peanut seed which had been furnished to them by the company, such value was not "proceeds" to which the bank's security could attach. Branch Banking & Trust Co. v. Columbian Peanut Co., 649 F. Supp. 1116 (E.D.N.C. 1986).

Buyer Can Not Designate Prior Value Given to Debtor as "Proceeds." — To allow a buyer to designate prior value given to the debtor as "proceeds" of a subsequent sale of collateral authorized by a secured party would seriously undermine the latter's interest, resulting in commercial uncertainty contrary to the objective of the UCC. Branch Banking & Trust Co. v. Columbian Peanut Co., 649 F. Supp. 1116 (E.D.N.C. 1986).

The mere fact that plaintiff had a security interest was insufficient to give rise to a claim against defendant under Article 9 or otherwise. Zorba's Inn, Inc. v. Nationwide Mut. Fire Ins. Co., 93 N.C. App. 332, 377 S.E.2d 797 (1989).

Right to Insurance Proceeds. — Unless otherwise agreed, a security agreement gives the secured party the rights to proceeds, including insurance proceeds. Zorba's Inn, Inc. v. Nationwide Mut. Fire Ins. Co., 93 N.C. App. 332, 377 S.E.2d 797 (1989).

Article 9 clearly gives the secured party a security interest in insurance proceeds which is enforceable against the debtor upon default. In other words, the secured party's interest in damaged or destroyed collateral continues in the insurance proceeds payable because of that damage or loss. Zorba's Inn, Inc. v. Nationwide Mut. Fire Ins. Co., 93 N.C. App. 332, 377 S.E.2d 797 (1989).

Having an enforceable security interest does not necessarily mean that a secured party has a claim against the insurer for those proceeds. The creditor's security interest in proceeds is enforceable against the debtor as soon as the proceeds are in the debtor's hands, and, it continuously perfected; that interest is superior to the claims of intervening creditors from the moment insurance is payable. Zorba's Inn, Inc. v. Nationwide Mut. Fire Ins. Co., 93 N.C. App. 332, 377 S.E.2d 797 (1989).

Where no action was ever demanded of defendant debtor to obtain insurance on his crops on behalf of plaintiff, the secured party, and where the debtor took out insurance on the crops at the insistence of, and for the benefit of, the United States Farmers Home Administration (FmHA) plaintiff had no claim against the insurer and was not justified in interfering with the insurer's payment of the proceeds; moreover, to the extent that the insurance proceeds may have exceeded the debt owed to FmHA, plaintiff was still not entitled to make a demand for payment of those proceeds until they fell into the hands of the defendant debtor. Lyon v. May, 108 N.C. App. 633, 424 S.E.2d 655, cert. denied, 333 N.C. 791, 431 S.E.2d 25 (1993).

Creditor Remains Perfected Where Substance of Debt Does Not Change. — Where creditor had a perfected security interest in debtor's accounts receivable, debtor exchanged the accounts receivable owed to it for promissory notes, and the transaction which transformed the accounts receivable into notes was done by related, if not identical, parties and was never disclosed to creditor, the substance of the debt had not changed and creditor remained perfected in the accounts receivable, even though they presently existed in the form of promissory notes and the creditor did not have possession of those notes as required by § 25-9-304. In re Guil-Park Farms, Inc., 90 Bankr. 180 (Bankr. W.D.N.C. 1988).

Language of Agreement Indicated Consent. — Appliance manufacturer's security interest in appliances sold to developer of apartments, which apartments were sold by developer to limited partnership after appliances were installed, was terminated as a result of the sale of the appliances to the limited partnership because the language in the security agreement between the developer and appliance manufacturer made it clear that appliance manufacturer, if not expressly then at least impliedly, consented to the resale. The court was troubled, however, by the fact that the same party served as president of the developer and as the only noncorporate general partner of the limited partnership. Whirlpool Corp. v. Dailey Constr., Inc., 110 N.C. App. 468, 429 S.E.2d 748 (1993).

Stated in Loman Garrett, Inc. v. Timco Mechanical, Inc., 93 N.C. App. 500, 378 S.E.2d 194 (1989); United States v. Currituck Grain, Inc., 6 F.3d 200 (4th Cir. 1993).

Cited in A.E. Pennebaker Co. v. Fuller, 691 F. Supp. 938 (W.D.N.C. 1988).

§ 25-9-307. Protection of buyers of goods.

Legal Periodicals. — For note on the conflict between the North Carolina Motor Vehicle Act and the UCC, see 65 N.C.L. Rev. 1156 (1987).

For comment on "Entrustment Under U.C.C. Section 2-403 and its Implications for Article 9," see 9 Campbell L. Rev. 407 (1987).

CASE NOTES

Stated in Branch Banking & Trust Co. v. Columbian Peanut Co., 649 F. Supp. 1116 (E.D.N.C. 1986); Whirlpool Corp. v. Dailey Constr., Inc., 110 N.C. App. 468, 429 S.E.2d 748 (1993); United States v. Currituck Grain, Inc., 6 F.3d 200 (4th Cir. 1993).

§ 25-9-309. Protection of purchasers of instruments, documents and securities.

Nothing in this article limits the rights of a holder in due course of a negotiable instrument (G.S. 25-3-302) or a holder to whom a negotiable document of title has been duly negotiated (G.S. 25-7-501) or a bona fide purchaser of a security (G.S. 25-8-302) and such holders or purchasers take priority over an earlier security interest even though perfected. Filing under this article does not constitute notice of the security interest to such holders or purchasers. (1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 1989 (Reg. Sess., 1990), c. 1024, s. 8(m), (n).)

Editor's Note. — The amendment by 1989 (Reg. Sess., 1990), c. 1024, s. 8(m), (n) was a conforming amendment to the amendments to Article 8 of this Chapter that were adopted in 1989.

Effect of Amendments. — The 1989 (Reg. Sess., 1990) amendment, effective July 27, 1990, substituted "instruments, documents and securities" for "instruments and documents" in the catchline, and substituted "G.S. 25-8-302" for "G.S. 25-8-301" in the first sentence.

§ 25-9-311. Alienability of debtor's rights; judicial process.

CASE NOTES

Stated in Loman Garrett, Inc. v. Timco Mechanical, Inc., 93 N.C. App. 500, 378 S.E.2d 194 (1989).

§ 25-9-312. Priorities among conflicting security interests in the same collateral.

(1) The rules of priority stated in other sections of this part and in the following sections shall govern when applicable: G.S. 25-4-208 with respect to the security interests of collecting banks in items being collected, accompanying documents and proceeds; G.S. 25-9-103 on security interests related to other jurisdictions; G.S. 25-9-114 on consignments.

(2) A perfected security interest in crops for new value given to enable the debtor to produce the crops during the production season and given not more than three months before the crops become growing crops by planting or otherwise takes priority over an earlier perfected security interest to the extent that such earlier interest secures obligations due more than six months before the crops become growing crops by planting or otherwise, even though the person giving new value had knowledge of the earlier security interest.

(3) A perfected purchase money security interest in inventory has priority over a conflicting security interest in the same inventory and also has priority in identifiable cash proceeds received on or before the delivery of the inventory to a buyer if

(a) the purchase money security interest is perfected at the time the debtor receives possession of the inventory; and

(b) the purchase money secured party gives notification in writing to the holder of the conflicting security interest if the holder had filed a financing statement covering the same types of inventory (i) before the date of the filing made by the purchase money secured party, or (ii) before the beginning of the 21-day period where the purchase money security interest is temporarily perfected without filing or possession (subsection (5) of G.S. 25-9-304); and

(c) the holder of the conflicting security interest receives the notification within five years before the debtor receives possession of the inventory; and

(d) the notification states that the person giving the notice has or expects to acquire a purchase money security interest in inventory of the debtor, describing such inventory by item or type.

(4) A purchase money security interest in collateral other than inventory has priority over a conflicting security interest in the same collateral or its proceeds if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within 20 days thereafter.

(5) In all cases not governed by other rules stated in this section (including cases of purchase money security interests which do not qualify for the special priorities set forth in subsections (3) and (4) of this section), priority between conflicting security interests in the same collateral shall be determined according to the following rules:

(a) Conflicting security interests rank according to priority in time of filing or perfection. Priority dates from the time a filing is first made covering the collateral or the time the security interest is first perfected, whichever is earlier, provided that there is no period thereafter when there is neither filing nor perfection.

(b) So long as conflicting security interests are unperfected, the first to attach has priority.

(6) For the purposes of subsection (5) a date of filing or perfection as to collateral is also a date of filing or perfection as to proceeds.

(7) If future advances are made while a security interest is perfected by filing, the taking of possession, or under G.S. 25-8-321 on securities, the security interest has the same priority for the purposes of subsection (5) with respect to the future advances as it does with respect to the first advance. If a commitment is made before or while the security interest is so perfected, the security interest has the same priority with respect to advances made pursuant thereto. In other cases a perfected security interest has priority from the date the advance is made. (1866-7, c. 1, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C.S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 196, s. 4; 1955, c. 816; 1957, c. 999; 1965, c. 700, s. 1; 1967, c. 24, s. 13; 1975, c. 862, s. 7; 1979, c. 404, s. 2; 1989 (Reg. Sess., 1990), c. 1024, s. 8(o).)

Editor's Note. — The amendment by 1989 (Reg. Sess., 1990), c. 1024, s. 8(o) was a conforming amendment to the amendments to Article 8 of this Chapter that were adopted in 1989.

Effect of Amendments. — The 1989 (Reg. Sess., 1990) amendment, effective July 27, 1990, in the first sentence of subsection (7), substituted "by filing, the taking of possession, or under G.S. 25-8-321 on securities," for "by filing or the taking of possession."

Legal Periodicals. — For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions," see 8 Campbell L. Rev. 505 (1986).

CASE NOTES

Having an enforceable security interest does not necessarily mean that a secured party has a claim against the insurer for those proceeds. The creditor's security interest in proceeds is enforceable against the debtor as soon as the proceeds are in the debtor's hands, and, it continuously perfected, that interest is superior to the claims of intervening creditors from the moment insurance is payable. Zorba's Inn, Inc. v. Nationwide Mut. Fire Ins. Co., 93 N.C. App. 332, 377 S.E.2d 797 (1989).

Lender with Perfected Security Interest in Note Had Priority Over Unperfected Lender of Same Note. — Where debtor used the same note as collateral for loans from two separate lenders, the lender with a perfected security interest in the note, due to his possession of it, had priority over the unperfected lender and was entitled to collect all or any portion of the note as agreed by the debtor until paid in full, and had no liability to the unperfected lender. A.E. Pennebaker Co. v. Fuller, 691 F. Supp. 938 (W.D.N.C. 1988).

Where defendant had a perfected security interest in a note due to possession of that note when the maker thereof used the note as collateral to secure a loan from plaintiff, plaintiff's security agreement was subject to defendant's security interest. A.E. Pennebaker Co. v. Fuller, 691 F. Supp. 938 (W.D.N.C. 1988).

Maker of a note secured by a deed of trust was obligated to make payments to possessor of the note and deed of trust until the note was paid in full. A.E. Pennebaker Co. v. Fuller, 691 F. Supp. 938 (W.D.N.C. 1988).

§ 25-9-313. Priority of security interests in fixtures.

Legal Periodicals. — For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions," see 8 Campbell L. Rev. 505 (1986).

CASE NOTES

Creditor who did not file financing statement did not have perfected purchase money security interest in windows and gutters which were attached to and became a part of a house as over against the trustee in bankruptcy. In re Hinson, 77 Bankr. 34 (Bankr. M.D.N.C. 1987).

Secured Party Held Not Entitled to Possession of Barns. — Secured creditor was not entitled under section (5) of this section to possession of tobacco barns which had been determined to be fixtures where the debtor's right to remove the barns had terminated and secured party's security interest had expired. United States v. Gaskins, 748 F. Supp. 366 (E.D.N.C. 1990).

§ 25-9-315. Priority when goods are commingled or processed.

Legal Periodicals. — For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions," see 8 Campbell L. Rev. 505 (1986).

For note, "Check Kiting: The Inadequacy of the Uniform Commercial Code," see 1986 Duke L.J. 728.

PART 4.

FILING.

§ 25-9-401. Place of filing; erroneous filing; removal of collateral.

(1) The proper place to file in order to perfect a security interest is as follows:

(a) when the collateral is equipment used in farming operations, farm products, accounts or general intangibles arising from or relating to the sale of farm products by a farmer, or consumer goods, then in the office of the register of deeds in the county of the debtor's residence if the debtor is a resident of this State, but in the office of the register of deeds in the county where the goods are kept if the debtor is not a resident of this State. When the collateral is farm products, an additional filing must be made in the office of the Secretary of State.

(b) when the collateral is timber to be cut or is minerals or the like (including oil and gas) or accounts subject to subsection (5) of G.S. 25-9-103, or when the financing statement is filed as a fixture filing (G.S. 25-9-313) and the collateral is goods which are or are to become fixtures, then in the office of the register of deeds in the county where the land is located;

(c) in all other cases, in the office of the Secretary of State and in addition, if the debtor has a place of business in only one county of this State, also in the office of the register of deeds of such county, or, if the debtor has no place of business in this State, but resides in the State, also in the office of the register of deeds of the county in which he resides.

(2) A filing which is made in good faith in an improper place or not in all of the places required by this section is nevertheless effective with regard to any collateral as to which the filing complied with the requirements of this article and is also effective with regard to collateral covered by the financing statement against any person who has knowledge of the contents of such financing statement.

(3) A filing which is made in the proper place in this State continues effective even though the debtor's residence or place of business or the location of the collateral or its use, whichever controlled the original filing, is thereafter changed.

(4) The rules stated in G.S. 25-9-103 determine whether filing is necessary in this State.

(5) A filing which is made in the proper place in this State prior to January 1, 1985, continues to be effective even though under this section the place of filing has been changed. The effectiveness of any financing statement or continuation statement filed prior to January 1, 1985, may be continued by a continuation statement or amended as permitted by the Uniform Commercial Code, except that if this section requires a filing in an office where there was no previous financing statement, a new financing statement meeting the requirements of this section shall be filed in that office. Such new financing statement operating as a continuation statement may be filed within six months before the perfection of the security interest would otherwise lapse. Any such financing statement may be signed by either the debtor or the secured party. It shall identify the original financing statement and any amendment or continuation thereof, state the office where and the date when each filing was made, and state the filing number thereof and also by the most current file number if any continuation was filed.

(6) For the purposes of this section, the residence of an organization is its place of business if it has one or its chief executive office if it has more than one place of business. (1866-7, c. 1, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C.S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 182, s. 3; c. 196, s. 2; 1955, c. 816; 1957, cc. 564, 999; 1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 1983 (Reg. Sess., 1984), c. 1116, ss. 41, 42; 1989, c. 523, s. 3.)

Effect of Amendments. — The 1989 amendment, effective October 1, 1989, added "and also by the most current file number if any continuation was filed" at the end of subsection (5).

CASE NOTES

Cited in Waterhouse v. Carolina Limousine Mfg., Inc., 96 N.C. App. 109, 384 S.E.2d 293 (1989).

§ 25-9-402. Formal requisites of financing statement; amendments; mortgage as financing statement.

(1) A financing statement is sufficient if it gives the names of the debtor and the secured party, is signed by the debtor, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral. A financing statement may be filed before a security agreement is made or a security interest otherwise attaches. When the financing statement covers crops growing or to be grown, the statement must indicate that the collateral is or includes crops, must contain a description of the real estate concerned, and must contain the county of the debtor's residence, or where the debtor is not a resident of this State the county where the crops are growing or to be grown. When the financing statement covers timber to be cut or covers minerals or the like (including oil and gas) or accounts subject to subsection (5) of G.S. 25-9-103, or when the financing statement is filed as a fixture filing (G.S. 25-9-313) and the collateral is goods which are or are to become fixtures, the statement must also comply with subsection (5). A copy of the security agreement is sufficient as a financing statement if it contains the above information and is signed by the debtor. A carbon, photographic or other reproduction of a security agreement or a financing statement is sufficient as a financing statement if the security agreement so provides or if the original has been filed in this State.

(2) A financing statement which otherwise complies with subsection (1) is sufficient when it is signed by the secured party instead of the debtor if it is filed to perfect a security interest in

(a) collateral already subject to a security interest in another jurisdiction when it is brought into this State, or when the debtor's location is changed to this State. Such a financing statement must state that the collateral was brought into this State or that the debtor's location was changed to this State under such circumstances; or

(b) proceeds under G.S. 25-9-306 if the security interest in the original collateral was perfected. Such a financing statement must describe the original collateral; or

(c) collateral as to which the filing has lapsed; or

(d) collateral acquired after a change of name, identity or corporate structure of the debtor (subsection (7)).

(3) A form substantially as follows is sufficient to comply with subsection (1):

Name of debtor (or assignor) ....
Address ....
Name of secured party (or assignee) ....
Address ....

1. This financing statement covers the following types (or items) of property:
   (Describe) ....
2. (If collateral is crops) The above described crops are growing or are to be grown on:
   (Describe Real Estate) ....

3. (If applicable) The above goods are to become fixtures on* ...
*Where appropriate substitute either "The above timber is standing on . . ." or "The above minerals or the like (including oil and gas) or accounts will be financed at the wellhead or minehead of the well or mine located on . . ."

(Describe Real Estate) ....

(If the debtor does not have an interest of record) The name of a record owner is ....

4. (If products of collateral are claimed) Products of the collateral are also covered.

(use	....
whichever	Signature of Debtor (or Assignor)
is	....
applicable)	Signature of Secured Party (or Assignee)

(4) A financing statement may be amended by filing a writing signed by both the debtor and the secured party. An amendment does not extend the period of effectiveness of a financing statement. If any amendment adds collateral, it is effective as to the added collateral only from the filing date of the amendment. In this article, unless the context otherwise requires, the term "financing statement" means the original financing statement and any amendments.

(5) A financing statement covering timber to be cut or covering minerals or the like (including oil and gas) or accounts subject to subsection (5) of G.S. 25-9-103, or a financing statement filed as a fixture filing (G.S. 25-9-313) must contain a description of the real estate. If the debtor does not have an interest of record in the real estate, the financing statement must show the name of a record owner. A financing statement filed as a fixture filing (G.S. 25-9-313) on a form shall have the appropriate box checked to indicate that the collateral is, or includes, fixtures. If (a) a copy of a security agreement is filed as a financing statement, as authorized by G.S. 25-9-402, or (b) a nonstandard form is filed, to perfect security interests in fixtures, the secured party or other filer shall attach thereto a form financing statement with the appropriate block checked to indicate that the collateral is, or includes, fixtures. If a financing statement is not marked as required by this subsection, it shall not be required to be indexed pursuant to G.S. 25-9-403(7).

(6) A mortgage or deed of trust is effective as a financing statement filed as a fixture filing from the date of its recording if

(a) the goods are described in the mortgage or deed of trust by item or type; and

(b) the goods are or are to become fixtures related to the real estate described in the mortgage or deed of trust; and

(c) the mortgage or deed of trust complies with the requirements for a financing statement in this section; and

(d) the mortgage or deed of trust is duly recorded in the real estate records. Such a mortgage or deed of trust shall not be indexed or filed in the Uniform Commercial Code files. No fee with reference to such a mortgage or deed of trust is required other than the regular recording and satisfaction fees with respect to the mortgage or deed of trust.

(7) A financing statement sufficiently shows the name of the debtor if it gives the individual, partnership or corporate name of the debtor, whether or not it adds other trade names or names of partners. Where the debtor so changes his name or in the case of an

organization its name, identity or corporate structure that a filed financing statement becomes seriously misleading, the filing is not effective to perfect a security interest in collateral acquired by the debtor more than four months after the change, unless a new appropriate financing statement is filed before the expiration of that time. A filed financing statement remains effective with respect to collateral transferred by the debtor even though the secured party knows of or consents to the transfer.

(8) A financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading.

(9) The Secretary of State shall have the authority to promulgate, issue and prescribe such financing statement forms and such other forms as he deems necessary to be used as standard forms for any filing contemplated by any section of this article. (1899, cc. 17, 247; 1901, cc. 329, 704; 1903, c. 489; 1905, cc. 226, 319; Rev., s. 2055; 1907, c. 843; 1909, c. 532; P.L. 1913, c. 49; C.S., s. 2490; 1925, c. 285, s. 1; 1931, c. 196; 1933, c. 101, s. 6; 1945, c. 182, s. 2; c. 196, s. 2; 1951, c. 926, s. 1; 1955, c. 386, s. 1; 1957, c. 564; 1961, c. 574; 1965, c. 700, s. 1; 1969, c. 1115, s. 1; 1975, c. 862, s. 7; 1983 (Reg. Sess., 1984), c. 1116, s. 43; 1989, c. 523, s. 7.)

Effect of Amendments. — The 1989 amendment, effective January 1, 1990, in subsection (5), substituted the present third sentence for the former third and last sentences which read "A financing statement filed as a fixture filing (G.S. 25-9-313) must bear the statement within 'Collateral is or includes fixtures' or its substantial equivalent or have checked the appropriate box identifying 'FIXTURES.' If a copy of a security agreement is filed as a financing statement, as authorized by G.S. 25-9-402, to perfect security interests in fixtures, the secured party or other filer shall stamp or print conspicuously on the face of the first page of such copy the legend 'Collateral is or includes fixtures'," and added the last two sentences.

Legal Periodicals. —

For comment, "Return to the Conservative View of Security Agreements in Commercial Transactions," see 8 Campbell L. Rev. 505 (1986).

For article, "Public Filing and Personal Property Leases: Questions of Definition and Doctrine," see 22 Wake Forest L. Rev. 425 (1987).

CASE NOTES

Use of Two Different Names. — Where the debtor's legal name contained the word "seventeen," and on a UCC-1 that word was interchanged with "17," those who did business with the debtor would have to search both the numerical and alphabetical indices; therefore, such an error was not minor and the filing was defective. Hinson v. Centura Bank (In re Seventeen S. Garment Co.), 145 Bankr. 511 (E.D.N.C. 1992).

Applied in NCNB Nat'l Bank v. Major Leasing, Inc., 140 Bankr. 826 (Bankr. N.D. Ga. 1991).

Quoted in Carter v. Holland (In re Carraway), 65 Bankr. 51 (Bankr. E.D.N.C. 1986).

Cited in Progressive Sales, Inc. v. Williams, Willeford, Boger, Grady & Davis, 86 N.C. App. 51, 356 S.E.2d 372 (1987).

§ 25-9-403. What constitutes filing; duration of filing; effect of lapsed filing; duties of filing officer.

(1) Presentation for filing of a financing statement and tender of the filing fee or acceptance of the statement by the filing officer constitutes filing under this article.

(2) Except as provided in subsection (6), or in Article 12 of Chapter 44, a filed financing statement is effective for a period of five years from the date of filing. The effectiveness of a filed financing statement lapses on the expiration of the five-year period unless a continuation statement is filed prior to the lapse. If a security interest perfected by filing exists at the time insolvency proceedings are commenced by or against the debtor, the security interest remains perfected until termination of the insolvency proceedings and thereafter for a period of 60 days or until expiration of the five-year period, whichever occurs later. Upon lapse the security interest becomes unperfected, unless it is perfected without filing. If the security interest becomes unperfected upon lapse, it is deemed to have been unperfected as against a person who became a purchaser or lien creditor before lapse.

(3) A continuation statement may be filed by the secured party within six months prior to the expiration of the five-year period specified in subsection (2). Any such continuation statement must be signed by the secured party, identify the original statement by file number and also by the most current file number if any continuation was filed and state that the original statement is still effective. A continuation statement signed by a person other than the secured party of record must be accompanied by a separate written statement of assignment signed by the secured party of record and complying with subsection (2) of G.S. 25-9-405, including payment of the required fee. Upon timely filing of the continuation statement, the effectiveness of the original statement is continued for five years after the last date to which the filing was effective whereupon it lapses in the same manner as provided in subsection (2) unless another continuation statement is filed prior to such lapse. Succeeding continuation statements may be filed in the same manner to continue the effectiveness of the original statement. Unless a statute on disposition of public records provides otherwise, the filing officer may remove a lapsed statement from the files and destroy it immediately if he has retained a microfilm or other photographic record, or in other cases after one year after the lapse. The filing officer shall so arrange matters by physical annexation of financing statements to continuation statements or other related filings, or by other means, that if he physically destroys the financing statements of a period more than five years past, those which have been continued by a continuation statement or which are still effective under subsection (6) shall be retained. Any continuation statement which is not filed in accordance with the requirements set forth herein and during the stated time periods set forth above shall be invalid.

(4) A filing officer shall mark each statement with a file number and with the date and hour of filing and shall hold the statement or a microfilm or other photographic copy thereof for public inspection. In addition the filing officer shall index the statement according to

the name of the debtor and shall note in the index the file number given in the statement.

(5) The uniform fee for filing and indexing and for stamping a copy furnished by the secured party to show the date and place of filing for an original financing statement or for a continuation statement is eight dollars ($8.00).

(6) A real estate mortgage which is effective as a fixture filing under subsection (6) of G.S. 25-9-402 remains effective as a fixture filing until the mortgage is redeemed or satisfied of record or its effectiveness otherwise terminates as to the real estate.

(7) When a financing statement covers timber to be cut or covers minerals or the like (including oil and gas) or accounts subject to subsection (5) of G.S. 25-9-103, or is filed as a fixture filing, the filing officer, in addition to complying with subsection (4) of this section, shall:

(a) index the statements in the Uniform Commercial Code index to financing statements so as to reflect the name of any record owner given in the statement. When the debtor is not the record owner, the filing officer shall enter the name of the record owner in the place designated for entry of the name of the debtor and shall stamp or print conspicuously beneath the surname of the record owner the legend "RECORD OWNER" and shall note therein the file number of the financing statement. When the debtor is also the record owner, the filing officer shall make one index entry in the name of the debtor and shall stamp or print conspicuously beneath his surname the legend, "RECORD OWNER." The filing officer shall also:

(b) index the statements in the real estate indexes under the names of the debtor and any owner of record shown on the financing statement in the same fashion as if they were the mortgagors in a mortgage of the real estate described, and, to the extent that the law of this State provides for indexing of mortgages under the name of the mortgagee, under the name of the secured party as if he were the mortgagee thereunder, or where indexing is by description in the same fashion as if the financing statement were a mortgage of the real estate described. (1866-7, c. 1, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C.S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 182, ss. 2, 4; c. 196, s. 2; 1955, c. 386, ss. 1, 2; c. 816; 1957, cc. 564, 999; 1961, c. 574; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1969, c. 1115, s. 1; 1971, c. 1170; 1973, c. 1316, s. 1; 1975, c. 862, s. 7; 1977, cc. 156, 295; 1983, c. 713, s. 23; 1987, c. 792, s. 6; 1989, c. 523, s. 4; 1991, c. 164, s. 1.)

Effect of Amendments. — The 1987 amendment, effective October 1, 1987, substituted "eight dollars ($8.00)" for "five dollars ($5.00)" in subsection (5), deleted "for an approved statutory form statement as prescribed in G.S. 25-9-402 when printed on a standard-size form approved by the Secretary of State, and for all other statements, the fee is ten dollars ($10.00)" at the end of subdivision (5), and deleted a former second sentence of that subdivision, which read "There shall be an additional fee of two dollars ($2.00) for each financing statement and continuation statement subject to subsection (5) of G.S. 25-9-402."

The 1989 amendment, effective October 1, 1989, inserted "and also by the most current file number if any continuation was filed" in the second sentence of subsection (3).

The 1991 amendment, effective October 1, 1991, in the last sentence of subsection (4), deleted "and the address of the debtor" before "given in the statement."

CASE NOTES

Applied in United States v. Currituck Grain, Inc., 6 F.3d 200 (4th Cir. 1993).

§ 25-9-404. Termination statement.

(1) If a financing statement covering consumer goods is filed on or after July 1, 1976, then within 30 days after there is no outstanding secured obligation and no commitment to make advances, incur obligations or otherwise give value, the secured party must file with each filing officer with whom the financing statement was filed a termination statement to the effect that he no longer claims a security interest under the financing statement, which shall be identified by file number and also by the most current file number if any continuation was filed. In other cases whenever there is no outstanding secured obligation and no commitment to make advances, incur obligations or otherwise give value, the secured party must file with each filing officer with whom the financing statement was filed, a termination statement to the effect that he no longer claims a security interest under the financing statement, which shall be identified by file number and also by the most current file number if any continuation was filed. A termination statement signed by a person other than the secured party of record must be accompanied by a separate written statement of assignment signed by the secured party of record and complying with subsection (2) of G.S. 25-9-405, including payment of the required fee. If the affected secured party fails to file such a termination statement as required by this subsection within 30 days, he shall be liable to the debtor for one hundred dollars ($100.00), and in addition for any loss caused to the debtor by such failure.

(2) On presentation to the filing officer of such a termination statement, he must note it in the Uniform Commercial Code index and also, if the financing statement is subject to subsection (5) of G.S. 25-9-402, in the real estate index. If he has received the termination statement in duplicate, he shall return one copy of the termination statement to the secured party to show the time of receipt thereof. If the filing officer has a microfilm or other photographic record of the financing statement and of any related continuation statements, statement of assignment and statement of release, he may remove the originals from the files at any time after receipt of the termination statement, or if he has no such microfilm or other photographic record, he may remove them from the files at any time after one year after receipt of the termination statement. The termination statement shall then remain in the file for such period of time as the financing statement or a continuation statement would be effective under the five-year life provided in G.S. 25-9-403, and then may be destroyed.

(3) There shall be no fee charged for termination statements. (1945, c. 182, s. 5; c. 196, s. 3; 1961, c. 574; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1969, c. 1115, s. 1; 1973, c. 1316, ss. 2, 3; 1975, c. 862, s. 7; 1985, c. 221; 1989, c. 523, s. 5; 1991, c. 164, s. 2.)

Effect of Amendments. —

The 1989 amendment, effective October 1, 1989, inserted "and also by the most current file number if any continuation was filed" in both the first and second sentence of subsection (1).

The 1991 amendment, effective October 1, 1991, near the beginning of subsection (1), substituted "within 30 days" for "within one month or within 10 days following written demand by the debtor"; in the middle of the subsection substituted "file with each" for "on written demand by the debtor send the debtor, for each"; and near the end of the subsection substituted "this subsection within 30 days" for "this subsection, or to send such a termination statement within 10 days after proper demand therefor."

§ 25-9-405. Assignment of security interest; duties of filing officer; fees.

(1) A financing statement may disclose an assignment of a security interest in the collateral described in the financing statement by indication in the financing statement of the name and address of the assignee or by an assignment itself or a copy thereof on the face or back of the statement. On presentation to the filing officer of such a financing statement the filing officer shall mark the same as provided in G.S. 25-9-403(4). The uniform fee for filing, indexing, and furnishing filing data for a financing statement so indicating an assignment is eight dollars ($8.00).

(2) A secured party may assign of record all or part of his rights under a financing statement by the filing in the place where the original financing statement was filed of a separate written statement of assignment signed by the secured party of record and setting forth the name of the secured party of record and the debtor, the file number and also the most current file number if it has been continued and the date of filing of the financing statement and the name and address of the assignee and containing a description of the collateral assigned. A copy of the assignment is sufficient as a separate statement if it complies with the preceding sentence. On presentation to the filing officer of such a separate statement, the filing officer shall mark such separate statement with the date and hour of the filing. He shall note the assignment on the Uniform Commercial Code index of the financing statement, and in the case of a fixture filing, or a filing covering timber to be cut, or covering minerals or the like (including oil and gas) or accounts subject to subsection (5) of G.S. 25-9-103, he shall index in the real estate index the assignment under the name of the assignor as grantor and, to the extent that the law of this State provides for indexing the assignment of a mortgage under the name of the assignee, he shall index the assignment of the financing statement under the name of the assignee. The uniform fee for filing, indexing, and furnishing filing data about such a separate statement of assignment is eight dollars ($8.00). Notwithstanding the provisions of this subsection, an assignment of record of a security interest in a fixture contained in a mortgage effective as a fixture filing (subsection (6) of G.S. 25-9-402) may be made only by an assignment of the mortgage in the manner provided by the law of the State other than this Chapter.

(3) After the disclosure or filing of an assignment under this section, the assignee is the secured party of record. (1965, c. 700, s. 1; 1967, c. 24, s. 23; 1969, c. 1115, s. 1; 1973, c. 1316, ss. 4, 5; 1975, c.

862, s. 7; 1983, c. 713, ss. 24, 25; 1987, c. 792, ss. 7, 8; 1989, c. 523, s. 6.)

Effect of Amendments. — The 1987 amendment, effective October 1, 1987, substituted "eight dollars ($8.00)" for "five dollars ($5.00)" and deleted "when submitted on standard-size form approved by the Secretary of State, and for all other statements, the fee is ten dollars ($10.00)" at the end of subdivision (1), substituted "eight dollars ($8.00)" for "five dollars ($5.00)" and deleted "when submitted on a standard-size form approved by the Secretary of State, and for all other statements, the fee is ten dollars ($10.00)" at the end of the present next-to-last sentence of subsection (2), and deleted a former next-to-last sentence of that subsection, which read "When the assignment is of a financing statement subject to subsection (5) of G.S. 29-5-402, there shall be an additional fee of two dollars ($2.00)."

The 1989 amendment, effective October 1, 1989, inserted "and also the most current file number if it has been continued" in the first sentence of subsection (2).

§ 25-9-406. Release of collateral; duties of filing officer; fees.

A secured party of record may, by his signed statement, release all or a part of any collateral described in a filed financing statement. The statement of release is sufficient if it contains a description of the collateral being released, the name and address of the debtor, the name and address of the secured party, and the file number of the financing statement. A statement of release signed by a person other than the secured party of record must be accompanied by a separate written statement of assignment signed by the secured party of record and complying with subsection (2) of G.S. 25-9-405, including payment of the required fee. Upon presentation of such a statement of release to the filing officer he shall mark the statement with the hour and date of filing and shall note the same upon the margin of the index of the filing of the financing statement. The uniform fee for filing and noting such a statement of release is eight dollars ($8.00). (1965, c. 700, s. 1; 1967, c. 24, s. 25; 1969, c. 1115, s. 1; 1973, c. 1316, s. 6; 1975, c. 862, s. 7; 1983, c. 713, s. 26; 1987, c. 792, s. 9.)

Effect of Amendments. — The 1987 amendment, effective October 1, 1987, substituted "eight dollars ($8.00)" for "five dollars ($5.00)" at the end of the section, deleted "when submitted on standard-size form approved by the Secretary of State, and for all other statements, the fee is ten dollars ($10.00)" thereafter, and deleted a former final sentence, which read "There shall be an additional fee of two dollars ($2.00) when the statement of release affects a financing statement subject to subsection (5) of G.S. 25-9-402."

§ 25-9-407. Information from filing officer.

(1) If the person filing any financing statement, termination statement, statement of assignment or statement of release furnishes the filing officer a copy thereof, the filing officer shall upon request note upon the copy the file number and date and hour of the filing of the original and deliver or send the copy to such person.

(2) Upon request of any person, the filing officer shall issue his certificate for which he shall not be liable showing whether there is on file, on the date and hour stated therein, any presently effective financing statement naming a particular debtor and any statement

of assignment thereof and if there is, giving the date and hour of filing of each such statement and the names and addresses of each secured party therein. The uniform fee for such a certificate shall be eight dollars ($8.00). Where the Uniform Commercial Code index has been automated, the filing officer shall issue a computer printout of the index entries for a particular debtor for a fee of eight dollars ($8.00). Upon request the filing officer shall furnish a copy of any filed financing statement or statement of assignment for a uniform fee of one dollar ($1.00) per page. (1965, c. 700, s. 1; 1967, c. 562, s. 1; 1973, c. 1316, s. 7; 1975, c. 862, s. 7; 1983, c. 713, ss. 27, 28; 1987, c. 792, s. 10.)

Effect of Amendments. — The 1987 amendment, effective October 1, 1987, substituted "eight dollars ($8.00)" for "five dollars ($5.00)" and deleted "plus one dollar ($1.00) for each financing statement and for each statement of assignment reported therein" thereafter at the end of the second sentence of subsection (2), and substituted "eight dollars ($8.00)" for "five dollars ($5.00)" at the end of the third sentence of that subsection.

§ 25-9-408. Financing statements covering consigned or leased goods.

Legal Periodicals. — For article, "Public Filing and Personal Property Leases: Questions of Definition and Doctrine," see 22 Wake Forest L. Rev. 425 (1987).

PART 5.

DEFAULT.

§ 25-9-501. Default; procedure when security agreement covers both real and personal property.

CASE NOTES

The rights and remedies under this section are cumulative; therefore there was no double recovery by a creditor who was awarded a money judgment after having already repossessed debtor's car, because the car was worthless. See Ken-Mar Fin. v. Harvey, 90 N.C. App. 362, 368 S.E.2d 646, cert. denied, 323 N.C. 365, 373 S.E.2d 545 (1988).

Seller Entitled to VCR. — Where defendant purchased a VCR from plaintiff and he signed a purchase money security agreement, thereby granting plaintiff a purchase money security interest in the VCR, since a VCR is a consumer good, plaintiff did not have to file a financing statement in order to perfect its purchase money security interest in the VCR; therefore, when defendant failed to make any further payments for the VCR and defaulted on the security agreement, the plaintiff was entitled to recover possession of the VCR when it filed its action in small claims court. Kimbrell's of Sanford, N.C., Inc. v. KPS, Inc., 113 N.C. App. 830, 440 S.E.2d 329 (1994).

Debtor's Failure to Make Household Goods Exemption Election under § 1C-1601. — When debtor failed to make an election for an exemption under § 1C-1601, allowing debtor to retain $2,500 worth of household goods and furnishings free from judgment, there was no unfair or deceptive practice on the part of a creditor who took a nonpossessory, nonpurchase money security interest in debtor's household goods and furnishings, even if creditor failed to inform debtor that such an exemption was available. See Ken-Mar Fin. v. Harvey, 90 N.C. App. 362, 368 S.E.2d 646, cert. denied, 323 N.C. 365, 373 S.E.2d 545 (1988).

Because an exemption for household goods and furnishings is available at the election of a borrower, borrower's property is subject to creditor's action for repossession if borrower does not make the election, even if value of goods is listed on a security agreement. See Ken-Mar Fin. v. Harvey, 90 N.C. App. 362, 368 S.E.2d 646, cert. denied, 323 N.C. 365, 373 S.E.2d 545 (1988).

Stated in Gregory Poole Equip. Co. v. Murray, 105 N.C. App. 642, 414 S.E.2d 563 (1992).

§ 25-9-502. Collection rights of secured party.

CASE NOTES

Quoted in A.E. Pennebaker Co. v. Fuller, 691 F. Supp. 938 (W.D.N.C. 1988).

§ 25-9-503. Secured party's right to take possession after default.

CASE NOTES

Seller Entitled to VCR. — Where defendant purchased a VCR from plaintiff and he signed a purchase money security agreement, thereby granting plaintiff a purchase money security interest in the VCR, since a VCR is a consumer good, plaintiff did not have to file a financing statement in order to perfect its purchase money security interest in the VCR; therefore, when defendant failed to make any further payments for the VCR and defaulted on the security agreement, the plaintiff was entitled to recover possession of the VCR when it filed its action in small claims court. Kimbrell's of Sanford, N.C., Inc. v. KPS, Inc., 113 N.C. App. 830, 440 S.E.2d 329 (1994).

Cited in Lincoln v. Grinstead, 94 N.C. App. 122, 379 S.E.2d 671 (1989).

§ 25-9-504. Secured party's right to dispose of collateral after default; effect of disposition.

CASE NOTES

Editor's Note. — The citation to the case of Parks Chevrolet, Inc. v. Watkins, annotated under the catchline "Evidence as to Commercial Reasonableness of Resale Held Insufficient" in the main volume, should read "74 N.C. App. 719, 329 S.E.2d 728 (1985)."

Commercial reasonableness is a question of fact. Fritts v. Selvais, 103 N.C. App. 149, 404 S.E.2d 505 (1991).

The price received is one of the "terms" of the sale for purposes of this subsection. Fritts v. Selvais, 103 N.C. App. 149, 404 S.E.2d 505 (1991).

Three factors have been identified to give some guidance in determining the commercial reasonableness of the resale price of collateral: (1) the price reflected by price handbooks, (2) the fair market value of the collateral, and (3) the price received on a second resale. Fritts v. Selvais, 103 N.C. App. 149, 404 S.E.2d 505 (1991).

A person who is liable to a secured party under a repurchase agreement and takes possession of collateral pursuant to an agreement with the secured party has the rights and duties of a secured party. Joyce v. Cloverbrook Homes, Inc., 81 N.C. App. 270, 344 S.E.2d 58, cert. denied, 317 N.C. 704, 347 S.E.2d 42 (1986).

Lender's Liability Under Repurchase Agreement and § 25-9-505. — A lender who repossesses a car and transfers it to a dealer under a repurchase agreement is not liable for the dealer's failure to sell the car within ninety days of repossession as required by § 25-9-505(1). Brooks v. Wachovia Bank & Trust Co., 96 N.C. App. 89, 384 S.E.2d 288 (1989).

Guarantor May Waive Right to Commercially Reasonable Disposition of Debtor's Collateral. — While it is true that a debtor may not waive his entitlement to a commercially reasonable disposition of his collateral by a secured creditor, a guarantor may contractually waive his right to a commercially reasonable disposition of the debtor's collateral. Borg-Warner Acceptance Corp. v. Johnston, 97 N.C. App. 575, 389 S.E.2d 429 (1990), cert. denied, 333 N.C. 254, 424 S.E.2d 918 (1993).

Dealer's Repossession of Car Did Not Change It to "Inventory." — Where bank recorded a lien on the title of car, plaintiff recorded a second lien on the title of the car and the bank subsequently repossessed the car and assigned its lien on the auto to defendant dealer, defendant assignee did not need to give notice to plaintiff when it sold the car; the car was consumer goods at the time plaintiff entered the finance agreement and the automobile did not become inventory upon dealer's repossession. City Fin. Co. v. Massey Motor Co., 95 N.C. App. 623, 383 S.E.2d 454, cert. denied, 326 N.C. 47, 389 S.E.2d 86 (1990).

Stated in Gregory Poole Equip. Co. v. Murray, 105 N.C. App. 642, 414 S.E.2d 563 (1992).

Cited in Carter v. Holland (In re Carraway), 65 Bankr. 51 (Bankr. E.D.N.C. 1986); Stewart Office Suppliers, Inc. v. First Union Nat'l Bank, 97 N.C. App. 353, 388 S.E.2d 599 (1990).

§ 25-9-505. Compulsory disposition of collateral; acceptance of the collateral as discharge of obligation.

CASE NOTES

"Secured party" is not synonymous with "titleholder" and holding title is not a prerequisite to being a secured party within the context of subsection (1). Lincoln v. Grinstead, 94 N.C. App. 122, 379 S.E.2d 671 (1989).

Husband as Secured Party Although Title Was in Wife's Name. — Trial court did not commit error by treating husband as the converter of the motor vehicle even though the repossessed vehicle was titled in his wife's name only; where record revealed that defendant husband negotiated with plaintiff throughout the financial transaction regarding the sale of the vehicle, represented to plaintiff that the vehicle's transmission was in good condition, signed the sales agreement conveying the truck to plaintiff, and completed repossession forms with the Department of Motor Vehicles, husband was a party to sales agreement which created a security interest in the vehicle, and therefore was subject to the provisions of this section pertaining to compulsory disposition of collateral. Lincoln v. Grinstead, 94 N.C. App. 122, 379 S.E.2d 671 (1989).

Lender's Liability When Collateral Transferred Under Repurchase Agreement. — A lender who repossesses a car and transfers it to a dealer under a repurchase agreement is not liable for the dealer's failure to sell the car within ninety days of repossession as required by subsection (1) of this section. Brooks v. Wachovia Bank & Trust Co., 96 N.C. App. 89, 384 S.E.2d 288 (1989).

Cited in Carter v. Holland (In re Carraway), 65 Bankr. 51 (Bankr. E.D.N.C. 1986).

§ 25-9-506. Debtor's right to redeem collateral.

CASE NOTES

Cited in Northwestern Bank v. Roseman, 81 N.C. App. 228, 344 S.E.2d 120 (1986); Carter v. Holland (In re Carraway), 65 Bankr. 51 (Bankr. E.D.N.C. 1986).

§ 25-9-507. Secured party's liability for failure to comply with this part.

CASE NOTES

Mobile Home. — The trial court did not err by applying the consumer goods provision of subsection (1) of this section to a case involving failure to give notice of sale of a mobile home. Joyce v. Cloverbrook Homes, Inc., 81 N.C. App. 270, 344 S.E.2d 58, cert. denied, 317 N.C. 704, 347 S.E.2d 42 (1986).

Lender who repossesses car and transfers it to dealer under a repurchase agreement is not liable for the dealer's failure to sell the car within ninety days of repossession as required by § 25-9-505(1). Brooks v. Wachovia Bank & Trust Co., 96 N.C. App. 89, 384 S.E.2d 288 (1989).

PART 6.

PUBLIC SALE PROCEDURES.

§ 25-9-601. Disposition of collateral by public sale.

CASE NOTES

North Carolina has by statute, etc.—

This section creates the presumption that substantial compliance with its terms constitutes a commercially reasonable sale. Triad Bank v. Elliott, 101 N.C. App. 188, 399 S.E.2d 1 (1990).

Sale of two automobiles was commercially reasonable, even though one vehicle was mistakenly advertised as a 1977 Rolls Royce, when it was in fact a 1976 Rolls Royce, where the notice described the vehicle substantially as it was described in the security agreement, and the difference of one year in make, which may well have been a clerical error, was not a substantial deviation. Triad Bank v. Elliott, 101 N.C. App. 188, 399 S.E.2d 1 (1990).

Cited in Gregory Poole Equip. Co. v. Murray, 105 N.C. App. 642, 414 S.E.2d 563 (1992).

§ 25-9-602. Contents of notice of sale.

CASE NOTES

Applied in Triad Bank v. Elliott, 101 N.C. App. 188, 399 S.E.2d 1 (1990).

§ 25-9-603. Posting and mailing notice of sale.

CASE NOTES

Applied in Triad Bank v. Elliott, 101 N.C. App. 188, 399 S.E.2d 1 (1990).

Quoted in Gregory Poole Equip. Co. v. Murray, 105 N.C. App. 642, 414 S.E.2d 563 (1992).

§ 25-9-607. Disposition of proceeds of sale.

CASE NOTES

Cited in Gregory Poole Equip. Co. v. Murray, 105 N.C. App. 642, 414 S.E.2d 563 (1992).

Chapter 25A.

Retail Installment Sales Act.

Sec.
25A-2. "Consumer credit sale" defined.
25A-14. Finance charge rates and service charge for revolving charge account contracts.
25A-17. Additional charges for insurance.

Sec.
25A-27. Application of payments.
25A-32.1. Unearned finance charge credits on prepayment of loans secured by real property and mobile home loans.

§ 25A-1. Scope of act.

CASE NOTES

Class Actions Allowed. — When the General Assembly has wished to prevent class actions to enforce statutory claims for relief, where the relief sought was personal and penal in nature, it has said so expressly and unequivocally. The failure of the General Assembly to expressly prohibit class actions to enforce this statute convinces the Supreme Court that it intended to allow them for such purposes. Crow v. Citicorp Acceptance Co., 319 N.C. 274, 354 S.E.2d 459 (1987).

The court upheld the certification of a class comprising of Chapter 7 debtors whose cases were pending in the bankruptcy courts of the Eastern and Middle Districts of North Carolina on the date of certification who had a Sears revolving charge account governed by this Act that included a balance, as of each debtor's petition date, which represented the credit purchases of at least two items of personal property on which Sears retained security interests. Coggin v. Sears, Roebuck & Co., 155 Bankr. 934 (Bankr. E.D.N.C. 1993).

Pro Rata Application of Payments to Consolidated Purchases Allowed. — The North Carolina Retail Installment Sales Act provides a method for applying payments to consolidated purchases on a pro rata basis. In re Sherman, 126 Bankr. 684 (Bankr. E.D.N.C. 1987).

Cited in Addison v. Britt, 83 N.C. App. 418, 350 S.E.2d 158 (1986); Westminster Co. v. Union Mut. Stock Life Ins. Co. of Am., 95 N.C. App. 117, 381 S.E.2d 857 (1989).

§ 25A-2. "Consumer credit sale" defined.

(a) Except as provided in subsection (c) of this section, a "consumer credit sale" is a sale of goods or services in which

(1) The seller is one who in the ordinary course of business regularly extends or arranges for the extension of consumer credit, or offers to extend or arrange for the extension of such credit,

(2) The buyer is a natural person,

(3) The goods or services are purchased primarily for a personal, family, household or agricultural purpose,

(4) Either the debt representing the price of the goods or services is payable in installments or a finance charge is imposed, and

(5) The amount financed does not exceed twenty-five thousand dollars ($25,000) or, in the case of a debt secured by real property or a manufactured home as defined in G.S. 143-145(7), regardless of the amount financed.

(b) "Sale" includes but is not limited to any contract in the form of a bailment or lease if the bailee or lessee contracts to pay as compensation for use a sum substantially equivalent to or in excess of the aggregate value of the goods and services involved, and it is agreed that the bailee or lessee will become, or for no other or for a nominal consideration, has the option to become, the owner of the goods and services upon full compliance with his obligations under such contract.

The term also includes a contract in the form of a terminable bailment or lease of goods or services in which the bailee or lessee can renew the bailment or lease contract periodically by making the payment or payments specified in the contract if:

(1) The contract obligates the bailor or lessor to transfer ownership of the property to the bailee or lessee for no other or a nominal consideration (no more than ten percent (10%) of the cash price of the property at the time the bailor or lessor initially enters into the contract with the bailee or lessee) upon the making of a specified number of payments by the bailee or lessee; and

(2) The dollar total of the specified number of payments necessary to exercise the purchase option is more than ten percent (10%) in excess of the aggregate value of the property and services involved. For the purposes of this subsection, the value of goods shall be the average cash retail value of the goods. The value of services shall be the average retail value, if any, of such services, as determined by substantial cash sales of such services. If a contract is found to be a sale under this subsection, these values shall be used to determine the amount financed for purposes of G.S. 25A-15.

(c) A sale in which the seller allows the buyer to purchase goods or services pursuant to a credit card issued by someone other than a seller that is engaged in part or entirely in the business of selling goods or services or similar arrangement is not a consumer credit sale. A sale in which the seller allows the buyer to purchase goods or services pursuant to a credit card issued by the seller, a subsidiary or a parent corporation of the seller, a principal supplier of the seller or any corporation having shareholders in common with the seller holding over twenty-five percent (25%) of the voting stock in each corporation is a consumer credit sale within the terms of this Chapter.

(d) For the purposes of this Chapter, a consumer credit sale shall be deemed to have been made in this State, and therefore subject to the provisions of this Chapter, if the seller offers or agrees in this State to sell to a buyer who is a resident of this State, or if such buyer accepts or makes the offer in this State to buy, regardless of the situs of the contract as specified therein.

Any solicitation or communication to sell, oral or written, originating outside of this State, but forwarded to and received in this State by a buyer who is a resident of this State, shall be deemed to be an offer or agreement to sell in this State.

Any solicitation or communication to buy, oral or written, originating within this State, from a buyer who is a resident of this State, but forwarded to and received by a retail seller outside of this State, shall be deemed to be an acceptance or offer to buy in this State.

(e) If an advertisement for a terminable bailment or lease defined as a sale in subsection (b) above states the amount of any payment, the advertisement must also clearly and conspicuously state the following items, as applicable:

(1) A statement that the transaction advertised is a lease;

(2) The total amount of periodic payments necessary to acquire ownership or a statement that the consumer has the option to purchase the property and at what time;

(3) That the consumer acquires no ownership rights if either the property is not leased for the term required for ownership to transfer or the terms of purchase are not otherwise satisfied.

If an advertisement for a terminable bailment or lease defined as a sale in subsection (b) above refers to the right to acquire ownership, the advertisement must clearly and conspicuously state whether or not the consumer may terminate the lease at any time without penalty and that the consumer acquires no ownership rights if either the property is not leased for the term required for ownership to transfer or the terms of purchase are not otherwise satisfied.

No one shall advertise in connection with any terminable bailment or lease defined as a sale in subsection (b) above the ownership option as a means of deceiving any lessee into believing that he is purchasing the item of personal property. (1971, c. 796, s. 1; 1979, c. 706, s. 1; 1981, c. 970, s. 2; 1983, c. 686, ss. 2, 3; 1987, c. 282, s. 5; 1991, c. 602, s. 1.)

Effect of Amendments. — The 1987 amendment, effective June 4, 1987, substituted "manufactured home" for "mobile home" in subdivision (a)(5).

The 1991 amendment, effective July 1, 1991, and applicable to contracts made on or after that date, inserted "debt secured by real property or a" in subdivision (a)(5).

CASE NOTES

Applied in In re Frady, 141 Bankr. 600 (Bankr. W.D.N.C. 1991).

§ 25A-5. "Services" defined.

CASE NOTES

Applied in Westminster Co. v. Union Mut. Stock Life Ins. Co. of Am., 95 N.C. App. 117, 381 S.E.2d 857 (1989).

§ 25A-7. "Cash price" defined.

CASE NOTES

Applied in In re Frady, 141 Bankr. 600 (Bankr. W.D.N.C. 1991).

§ 25A-14. Finance charge rates and service charge for revolving charge account contracts.

(a) The finance-charge rate and either the annual charge or the monthly service charge for a consumer credit sale made under a revolving charge account contract may not exceed the rates and charge provided for revolving credit by G.S. 24-11.

(b) In the event the revolving charge account contract is secured in whole or in part by a security interest in real property, then the finance-charge rate shall not exceed the rate set out in G.S. 25A-15(d).

(c) No default or deferral charge shall be imposed by the seller in connection with a revolving charge-account contract, except as specifically provided for in G.S. 24-11(d1). (1971, c. 796, s. 1; 1983, c. 126, s. 7; 1991, c. 506, s. 7.)

Effect of Amendments. — The 1991 amendment, effective October 1, 1991, in subsection (a), inserted "and either the annual charge or the monthly service charge," substituted "under" for "pursuant to," inserted "and charge," substituted "G.S. 24-11" for "G.S. 24-11(a)," and deleted the second sentence, which read: "The annual fee provided in G.S. 24-11(a) may not be imposed"; and in subsection (c), substituted "G.S. 24-11(d1)" for "G.S. 24-11(a)".

§ 25A-15. Finance charge rates for consumer credit installment sale contracts.

Legal Periodicals. —

For note, "Civil Procedure — A Definition of 'Class' Under North Carolina Rule 23 — Crow v. Citicorp Acceptance Co.," see 23 Wake Forest L. Rev. 491 (1988).

§ 25A-17. Additional charges for insurance.

(a) As to revolving charge account contracts defined in G.S. 25A-11, in addition to the finance charges permitted in G.S. 24-11(a), a seller in a consumer credit sale may contract for and receive additional charges or premiums (i) for insurance written in connection with any consumer credit sale, against loss of or damage to property securing the debt pursuant to G.S. 25A-23, provided a clear, conspicuous and specific statement in writing is furnished by the seller to the buyer setting forth the cost of the insurance if obtained from or through the seller and stating that the buyer may choose the insurer through which the insurance is obtained; (ii) for credit life, credit accident and health, or credit unemployment insurance, written in connection with any consumer credit sale, provided the insurance coverage is not required by the seller and this fact is clearly disclosed to the buyer, and any buyer desiring such insurance coverage gives affirmative indication of such desire after disclosure of the cost of such insurance.

(b) As to revolving charge account contracts defined in G.S. 25A-11, insurance that is required by a seller and is not an additional charge permitted by subsection (a) of this section, shall be included in the finance charge as computed according to G.S. 24-11(a).

(c) As to consumer credit installment sale contracts defined in G.S. 25A-12, in addition to the finance charges permitted in G.S.

25A-15, a seller in a consumer credit sale may contract for and receive additional charges or premiums (i) for insurance written in connection with any consumer credit sale, for loss of or damage to property or against liability arising out of the ownership or use of property, provided a clear, conspicuous and specific statement in writing is furnished by the seller to the buyer setting forth the cost of the insurance if obtained from or through the seller and stating that the buyer may choose the person through which the insurance is to be obtained; (ii) for credit life, credit accident and health, or credit unemployment insurance, written in connection with any consumer credit sale, provided the insurance coverage is not required by the seller and this fact is clearly and conspicuously disclosed in writing to the buyer; and any buyer desiring such insurance coverage gives specific dated and separately signed affirmative written indication of such desire after receiving written disclosure to him of the cost of such insurance. (1971, c. 796, s. 1; 1993, c. 226, s. 15.)

Effect of Amendments. — The 1993 amendment, effective January 1, 1994, in subsection (a) added the subdivision (i) designation, added subdivision (ii) and made related changes; in subdivision (c)(ii) substituted "credit accident and health, or credit unemployment insurance" for "accident, health or loss of income insurance".

§ 25A-18. Confession of judgment.

CASE NOTES

Cited in Burton v. Blanton, 107 N.C. App. 615, 421 S.E.2d 381 (1992).

§ 25A-23. Collateral taken by the seller.

CASE NOTES

Cited in Sears, Roebuck & Co. v. Vandeusen, 155 Bankr. 358 (E.D.N.C. 1993).

§ 25A-27. Application of payments.

(a) Where a seller in a consumer credit sale makes a subsequent sale to a buyer and takes a security interest pursuant to G.S. 25A-23 in goods previously purchased by the buyer from the seller, the seller shall make application of payments received, for the purpose of determining the amount of the debt secured by the various security interests, as follows:

(1) The entire amount of all payments made prior to such subsequent purchase shall be deemed to have been applied to the previous purchases, and

(2) Unless otherwise designated by the buyer, the amount of down payment on such subsequent purchase shall be applied to the subsequent purchase, and

(3) All subsequent payments shall be applied first to finance charges and then to principal. The application of payments

to principal shall be applied to the various purchases on the basis that the first sums paid in shall be deemed applied to the oldest purchase or obligation assumed to satisfy the original debt secured by the purchase money security interest until payment is received in full and other payments shall be applied accordingly to all other purchases in the order that each obligation is assumed. At the time any original debt would have been satisfied by subsequent payments, the purchase money security interest in said purchase shall be extinguished.

(b) Where a seller and a buyer agree to consolidate two or more consumer credit installment sale contracts pursuant to G.S. 25A-31, the seller shall apply payments received, for the purpose of determining the amount of the debt secured by the various security interests, as follows:

(1) The entire amount of all payments received prior to the consolidation shall be applied to the respective contracts under which the payments were made, and

(2) All subsequent payments shall be applied first to finance charges and then to principal. The application of payments to principal shall be applied to the various purchases on the basis that the first sums paid in shall be deemed applied to the oldest purchase or obligation assumed to satisfy the original debt secured by the purchase money security interest until payment is received in full and other payments shall be applied accordingly to all other purchases in the order that each obligation is assumed. At the time any original debt would have been satisfied by subsequent payments, the purchase money security interest in said purchase shall be extinguished.

(c) For payments received by a seller on or after October 1, 1988, but before October 1, 1993, a seller may elect to apply the provisions of this section as the section read October 1, 1993, or as the section read September 30, 1993. A seller made this election when the seller determined, and disclosed to the buyer, how payments received on a consumer credit sale would be applied: either on a proportional basis or on a "first in - first out" basis with the payments applied first to finance charges and then to principal in the order that each obligation is assumed.

(d) The exclusive remedy for failure of a seller to apply payments of a buyer as required by subdivision (a)(3) or (b)(2) of this section during the period October 1, 1993, through October 1, 1996, is an order that the seller apply the payments as required by those provisions. (1971, c. 796, s. 1; 1993, c. 370, s. 2; 1993 (Reg. Sess., 1994), c. 745, s. 38.3(a).)

Editor's Note. — Session Laws 1993 (Reg. Sess., 1994), c. 745, which amended this section, in s. 38.3(b) provides: "G.S. 25A-27(c), as enacted by this section, does not apply to pending actions."

Effect of Amendments. — The 1993 amendment, effective October 1, 1993, rewrote subdivision (a)(3) and subdivision (b)(2).

The 1993 (Reg. Sess., 1994) amendment, effective July 15, 1994, added subsections (c) and (d).

CASE NOTES

Compliance Required. — Revolving chart account requiring that finance charges for newly purchased goods be satisfied before payments would be applied to previously purchased items expanded the existing security interest in prior purchases to secure not only their own purchase price but also the payment of finance charges on items bought later was an agreement that created a security interest in previously purchased property, and thereby required compliance with the apportionment provisions of this section. Sears, Roebuck & Co. v. Vandeusen, 155 Bankr. 358 (E.D.N.C. 1993).

Cited in In re Sherman, 126 Bankr. 684 (Bankr. E.D.N.C. 1987).

§ 25A-28. Form of consumer credit installment sale contract.

Legal Periodicals. — For survey of North Carolina construction law, with particular reference to unfair or deceptive acts or practices, see 21 Wake Forest L. Rev. 633 (1986).

§ 25A-32.1. Unearned finance charge credits on prepayment of loans secured by real property and mobile home loans.

(a) Notwithstanding any statutory or contractual provision to the contrary, in a consumer credit installment sale contract with an amount financed of five thousand dollars ($5000.00) or more secured by real estate or by a residential manufactured home as defined in G.S. 143-145(7), any buyer may satisfy the debt in full at any time before maturity, and in so satisfying the debt, shall be credited with all unearned finance charges as computed on the simple interest or actuarial method.

(b) If a seller obtains a judgment on a debt arising out of a consumer credit installment sale described in subsection (a) of this section, or if the seller forecloses or repossesses the collateral securing the debt, the seller shall credit the buyer with all unearned finance charges as computed on the simple interest or actuarial method as if the payment in full had been made on the date the judgment was obtained or 15 days after the foreclosure or repossession occurred, whichever is earlier. If the seller obtains a judgment and repossesses the collateral, the seller shall credit the buyer with all unearned finance charges as if payment in full had been made on the date of the judgment or 15 days after the repossession, whichever occurs earlier. (1991, c. 602, s. 2.)

Editor's Note. — Session Laws 1991, c. 602, s. 2, made this section effective July 1, 1991, and applicable to contracts made on or after that date.

§ 25A-37. Referral sales.

CASE NOTES

Referral Sale. — In essence, a referral sale is a transaction in which a person is induced to purchase goods or services upon the representation that the purchaser can reduce or recover the purchase price or earn a commission by referring other prospective buyers to the seller for similar purchases. Chapel Hill Spa Health Club, Inc. v. Goodman, 90 N.C. App. 198, 368 S.E.2d 60 (1988).

Referral Sales Condemned. — In recognition of the vast potential for deception and exploitation of the public inherent in referral sales and in furtherance of the vital state interest in protecting citizens from fraud, our legislature, by enacting this section, has condemned all referral sales contracts, declaring them both unlawful and unenforceable. Chapel Hill Spa Health Club, Inc. v. Goodman, 90 N.C. App. 198, 368 S.E.2d 60 (1988).

Fact that contingency in referral contract related to price of renewal rather than original membership was of little significance, since in either circumstance the promise of something for nothing would serve as the incentive to make a purchase. Chapel Hill Spa Health Club, Inc. v. Goodman, 90 N.C. App. 198, 368 S.E.2d 60 (1988).

Where spa represented to purchaser, in effect, that if she purchased an initial membership, she could then obtain an additional year or years of membership free by referring an adequate number of prospects to the spa, this transaction clearly constituted a sale of services with other consideration to the purchaser that is contingent upon the procurement of prospective customers provided by the purchaser. Thus, the contract between purchaser and the spa constituted a referral sale, in violation of this section, and was void and unenforceable. Chapel Hill Spa Health Club, Inc. v. Goodman, 90 N.C. App. 198, 368 S.E.2d 60 (1988).

§ 25A-39. Buyer's right to cancel.

Legal Periodicals. — For survey of North Carolina construction law, with particular reference to unfair or deceptive acts or practices, see 21 Wake Forest L. Rev. 633 (1986).

§ 25A-40. Form of agreement or offer; statement of buyer's rights.

Legal Periodicals. — For survey of North Carolina construction law, with particular reference to unfair or deceptive acts or practices, see 21 Wake Forest L. Rev. 633 (1986).

§ 25A-43. Unconscionability.

CASE NOTES

Stated in Sears, Roebuck & Co. v. Vandeusen, 155 Bankr. 358 (E.D.N.C. 1993).

§ 25A-44. Remedies and penalties.

CASE NOTES

Availability of Remedies. — In order to create a security interest in previously purchased property, the seller must provide for apportioning payments in the charge account contract. The failure to do so means that no security interest comes into existence and the remedies for a violation of this Act contained in this section do not apply. Sears, Roebuck & Co. v. Vandeusen, 155 Bankr. 358 (E.D.N.C. 1993).

Chapter 26.

Suretyship.

§ 26-3.1. Surety's recovery on obligation paid; no assignment necessary.

CASE NOTES

Sureties on bonds issued by principal cannot sue principal before paying all or part of the penal amount of the bonds. Harshaw v. Mustafa, 321 N.C. 288, 362 S.E.2d 541 (1987).

Time of Suit. — This section allows a surety to sue a principal on the original instrument or for reimbursement on the surety agreement. After three years, a suit on the latter theory would be barred by § 1-52. Where surety elects to sue on the underlying note under seal, he has the same rights the bank had on the original note. Thus, the 10-year statute of limitations, § 1-47, would apply. Adams v. Bass, 88 N.C. App. 599, 364 S.E.2d 194 (1988), cert. denied, 326 N.C. 363, 389 S.E.2d 810 (1990).

§ 26-5. Contribution among sureties.

CASE NOTES

III. Contribution Enforced.
  A. In General.

III. CONTRIBUTION ENFORCED.

A. In General.

Statute of Limitations. —
While the right to contribution among co-indemnitors or sureties has common law origin, since 1807 it has been a statutory right under the provisions of this section; accordingly, the applicable statute in this case provided that an action upon a liability created by statute must be brought within three years. Finch v. Barnes, 102 N.C. App. 733, 403 S.E.2d 552 (1991).

Plaintiff's claim in action involving right to contribution among co-indemnitors or sureties accrued or arose so as to start the running of the statute of limitations when he paid the debt or debts of his principal. Finch v. Barnes, 102 N.C. App. 733, 403 S.E.2d 552 (1991).

§ 26-7. Surety, indorser, or guarantor may notify creditor to take action.

CASE NOTES

I. General Consideration.

I. GENERAL CONSIDERATION.

Finding that language in guarantees served only to identify the guaranty as guaranty of payment and was not intended to waive this section comported with the rules of construction and the case law and would be upheld. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

In the parties' guaranty agreement, defendant promised not only to be liable for the entire balance of the note when it became due and payable upon a default, but also to make payment of any delinquent full installment, including delinquent interest 30 days after he had been given written notice of the default. Thus defendant's written promise to pay each individual installment upon default created an obligation covered by subsection (a) of this section. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

To be relevant on issue of implied waiver, evidence must show that defendant acted in manner which induced plaintiff to believe defendant intended to waive provisions of this section. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

Duty to mitigate arises only in tort actions and breach of contract actions. Defendant's rights and remedies are statutorily mandated by this section through § 26-9. These statutes do not require defendant, as guarantor, to mitigate the damages he suffered because of plaintiff's failure to comply with this section. Therefore, the court declined to expand the scope of the duty to mitigate. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

Evidence Held Sufficient. — Where note installment payment became due and payable on 1 January 1982, plaintiff notified defendant of the payment's delinquency on 19 January 1982, and defendant informed plaintiff on 25 January 1982 that he was exercising his rights under this section through § 26-9, the trial court's findings and conclusion, holding that defendant properly invoked subsection (a), were based on sufficient evidence. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

Under this statute, plaintiff's refusal to move against either farm or the farm's collateral to collect the balance of the note due released defendant, as guarantor, only to the extent he was prejudiced. If the solvency of the farm and the value of its collateral were equivalent to the same values existing when note became due, when defendant gave plaintiff this section's notice, defendant would not have been prejudiced by plaintiff's failure to act and would have continued to be liable for the entire amount of the note he originally guaranteed. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

Applied in Borg-Warner Acceptance Corp. v. Johnston, 97 N.C. App. 575, 389 S.E.2d 429 (1990); Resolution Trust Corp. v. Southwest Dev. Co., 807 F. Supp. 375 (E.D.N.C. 1992).

§ 26-8. Notice; how given; prima facie evidence thereof.

CASE NOTES

Applied in Resolution Trust Corp. v. Southwest Dev. Co., 807 F. Supp. 375 (E.D.N.C. 1992).

§ 26-9. Effect of failure of creditor to take action.

CASE NOTES

Duty to mitigate arises only in tort actions and breach of contract actions. Defendant's rights and remedies are statutorily mandated by § 26-7 through this section. These statutes do not require defendant, as guarantor, to mitigate the damages he suffered because of plaintiff's failure to comply with § 26-7. Therefore, the court declined to expand the scope of the duty to mitigate. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

Evidence Held Sufficient. — Where note installation payment became due and payable on 1 January 1982, plaintiff notified defendant of the payment's delinquency on 19 January 1982, and defendant informed plaintiff on 25 January 1982 that he was exercising his rights under § 26-7 through this section, the trial court's findings and conclusion, holding that defendant properly invoked subsection (a), were based on sufficient evidence. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

Applied in Resolution Trust Corp. v. Southwest Dev. Co., 807 F. Supp. 375 (E.D.N.C. 1992).

Cited in Community Bank & Trust Co. v. Copses, 953 F.2d 133 (4th Cir. 1991).

§ 26-12. Joinder of debtor by surety.

CASE NOTES

Defendant guarantors could not avail themselves of the rights and privileges afforded by this section where the principal filed bankruptcy and was subject to the exclusive jurisdiction of the United States District Court for the Western District of North Carolina; the statute expressly states that the principal must be joined as a party and to do so requires the surety to show that the state courts have jurisdiction over the principal. Borg-Warner Acceptance Corp. v. Johnston, 97 N.C. App. 575, 389 S.E.2d 429 (1990), cert. denied, 333 N.C. 254, 424 S.E.2d 918 (1993).

Applied in Resolution Trust Corp. v. Southwest Dev. Co., 807 F. Supp. 375 (E.D.N.C. 1992).

Quoted in Poughkeepsie Sav. Bank v. Harris, 833 F. Supp. 551 (W.D.N.C. 1993).

Cited in Resoulution Trust Corp. v. Southwest Dev. Co., 837 F. Supp. 122 (E.D.N.C. 1992).

STATE OF NORTH CAROLINA

DEPARTMENT OF JUSTICE

Raleigh, North Carolina

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I, Michael F. Easley, Attorney General of North Carolina, do hereby certify that the foregoing 1994 Cumulative Supplement to the General Statutes of North Carolina was prepared and published by The Michie Company under the supervision of the Department of Justice of the State of North Carolina.

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Attorney General of North Carolina